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A SYSTEMS ANALYSIS VIEW OF THE VIETNAM WAR 1965-1972

Editor: Thomas C. Thayer

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Volume 11

**ECONOMICS: WAR
COSTS AND INFLATION**

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SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

REPORT DOCUMENTATION PAGE		READ INSTRUCTIONS BEFORE COMPLETING FORM
1. REPORT NUMBER	2. GOV. ACCESSION NO.	3. RECIPIENT'S CATALOG NUMBER
None		
4. TITLE (and Subtitle)		5. TYPE OF REPORT & PERIOD COVERED
A SYSTEMS ANALYSIS VIEW OF THE VIETNAM WAR 1965-1972 VOLUMES 1-12		Final Report 1965-1972
7. AUTHOR(s)		6. PERFORMING ORG. REPORT NUMBER
Thomas C. Thayer		None
9. PERFORMING ORGANIZATION NAME AND ADDRESS		8. CONTRACT OR GRANT NUMBER(s)
OASD(SA)RP Southeast Asia Intelligence Division Pentagon Washington, D.C. 20301		None
11. CONTROLLING OFFICE NAME AND ADDRESS		10. PROGRAM ELEMENT, PROJECT, TASK AREA & WORK UNIT NUMBERS
OASD(PA&E)RP Asia Division Room 2C310, The Pentagon Washington, D.C. 20301		N/A
14. MONITORING AGENCY NAME & ADDRESS (if different from Controlling Office)		12. REPORT DATE
Same as Above		February 18, 1975
		13. NUMBER OF PAGES
		2793
		15. SECURITY CLASS. (of this report)
		Unclassified
		15a. DECLASSIFICATION/DOWNGRADING SCHEDULE
		N/A
16. DISTRIBUTION STATEMENT (of this Report)		
Distribution Unlimited. Suggest nomination to NTIS because material is of interest to scholars of the Vietnam War.		
17. DISTRIBUTION STATEMENT (of the abstract entered in Block 20, if different from Report)		
18. SUPPLEMENTARY NOTES		
19. KEY WORDS (Continue on reverse side if necessary and identify by block number)		
Southeast Asia Analysis Report RVNAF		
OASD(Systems Analysis) Hamlet Evaluation System		
SEA Analysis Report SE Asia Air Operations		
VC/NVA SE Asia Deployments		
Pacification SE Asia Logistics/Construction		
20. ABSTRACT (Continue on reverse side if necessary and identify by block number)		
This twelve volume set includes every article printed in the fifty issue series of the <u>Southeast Asia Analysis Report</u> . The SEA Analysis Report represented a month-by-month analysis of Vietnam War activity including forces and manpower, VC/NV operations, Allied ground, naval and air operations, RVNAF, casualties and losses, population security, war costs and inflation and construction and port operations in South Vietnam.		

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SECURITY CLASSIFICATION OF THIS PAGE (When Data Entered)

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A SYSTEMS ANALYSIS VIEW OF THE VIETNAM WAR: 1965-1972 .

Volume 11. ECONOMICS: WAR COSTS AND INFLATION .

VOLUME 11

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Final rept.,

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Editor: Thomas C. Thayer

U.S. GOVERNMENT PRINTING OFFICE: 1973

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A SYSTEMS ANALYSIS VIEW OF THE VIETNAM WAR: 1965-1972

Contents of the 12 Volumes

- Volume 1 - The Situation In Southeast Asia
- Volume 2 - Forces and Manpower
- Volume 3 - Viet Cong--North Vietnamese Operations
- Volume 4 - Allied Ground and Naval Operations
- Volume 5 - The Air War
- Volume 6 - Republic of Vietnam Armed Forces (RVNAF)
- Volume 7 - Republic of Vietnam Armed Forces (RVNAF)
- Volume 8 - Casualties and Losses
- Volume 9 - Population Security
- Volume 10 - Pacification and Civil Affairs
- Volume 11 - Economics: War Costs and Inflation
- Volume 12 - Construction and Port Operations in South Vietnam

A Systems Analysis View Of The Vietnam War: 1965-1972

Volume II

ECONOMICS: WAR COSTS AND INFLATION

1. COSTS OF THE WAR

	<u>Date</u>	<u>Page</u>
Impact Of Vietnam War On U.S. Balance Of Payments	May 67	1
Impact Of Vietnam Conflict On Great Society Programs	Sep 67	4
The Cost Of Bombing North Vietnam	Dec 67	8
The Bombing - Its Economic Costs And Benefits To North Vietnam	Feb 68	11
The Cost Of The Vietnam War	Aug 68	24
RVNAF And U.S. Advisory Costs FY 65 - FY 67	Dec 68	26
Cost Of The War In Vietnam	Sep 69	32
Where The Money Goes: A Program Budget For The Vietnam War FY 69	Nov/Dec 70	39
Where The Money Went	Aug/Oct 71	49

2. INFLATION IN SOUTH VIETNAM

Economic Impact - Korea and SVN Buildups	Feb 67	58
DOD Piaster Spending In Vietnam	Mar 67	63
Inflationary Gap - CY 1967	Apr 67	64
SVN Inflation In CY 1967	May 67	71
Inflation In South Vietnam	Jun 67	79
Inflation, Wages and Incentives	Nov 67	84
Summary Of Inflation In SVN During CY 1967	Feb 68	89
Wage And Real Income Changes In South Vietnam	Jun 68	98
The Economic Situation In Vietnam For The First Six Months Of 1968	Jul 68	106
Budgetary And Foreign Exchange Impact Of The Civilianization Program	Sep 68	109
Inflation In RVN During 1968	Dec 68	110
Vietnam's Need For External Economic Assistance 1970-74	Jan 70	121

3. SPECIAL

Economic Warfare Against The Viet Cong	Jun 67	125
Economic Warfare Against The Viet Cong: A Rebuttal	Jul 67	129
Social And Economic Development In The SVN Highlands	Jul 67	131
Rice Production And Consumption	Aug 67	132
Rice Problems In SVN	Nov 67	135

INTRODUCTION

This volume, plus the other eleven volumes in the series, contains every article ever printed in the Southeast Asia Analysis Report (a few additional papers not printed in the report are occasionally included, too.).

Fifty issues of the Southeast Asia Analysis Report were published from January 1967 through January 1972 by the Southeast Asia office under the Assistant Secretary of Defense (Systems Analysis). The Report had two purposes. First, it served as a vehicle to distribute the analyses produced by Systems Analysis on Southeast Asia. It thus provided other agencies an opportunity to tell us if we were wrong and to help prevent research duplications. We solicited and received frequent rebuttals or comments on our analyses which sharpened our studies and stimulated better analysis by other agencies. Second, it was a useful management tool for getting more good work from our staff -- they knew they must regularly produce studies which would be read critically throughout the Executive Branch.

The first page of the Report stated that it "is not an official publication of the Department of Defense, and does not necessarily reflect the views of the Secretary of Defense, Assistant Secretary of Defense (Systems Analysis), or comparable officials." The intent was solely to improve the quality of analysis on Southeast Asia problems -- and to stimulate further thought and discussion. The report was successful in doing precisely this.

We distributed about 350 copies of the Report each month to OSD (Office of the Secretary of Defense), the Military Departments, CINCPAC, and Saigon, and to other interested agencies such as the Paris Delegation, AID, State Department, CIA and the White House Staff. Most copies circulated outside OSD were in response to specific requests from the individual person or agency. Our readership included many of the key commanders, staff officers, and analysts in Washington and in the field. Their comments were almost always generous and complimentary, even when they disagreed with our conclusions. Some excerpts appear below:

"I believe the 'SEA Analysis Report' serves a useful purpose, and I would like to see its present distribution continued." (Deputy Secretary of Defense, 31 May 1968)

"We used a highly interesting item in your May Analysis Report as the basis for a note to the Secretary, which I've attached." (State Department, 28 June 1967)

"We were all most impressed with your first monthly Southeast Asia Analysis Report. Not only do we wish to continue to receive it, but we would appreciate it if we could receive 4 (four) copies from now on." (White House, 9 February 1967)

"Ambassador _____ has asked me to tell you that he has much appreciated and benefited from the studies and analyses of this publication." (State Department/White House, 24 January 1969)

"Congratulations on your January issue. The 'Situation in South Vietnam' article was especially interesting and provoking." (State Department, 24 January 1969)

"I let Ambassador _____ take a swing at the paper. He made several comments which may be of interest to you. Many thanks for putting us back on distribution for your report. Also, despite the return volley, I hope you will continue sending your products." (MACV-CORDS, 17 June 1968)

"As an avid reader (and user) of the SEA Analysis Report, I see a need for more rounded analyses in the pacification field and fewer simplistic constructs." (MACV-DEPCORDS, 17 April 1968)

"The SEA Programs Division is to be commended for its perceptive analysis of topics that hold the continuing concern of this headquarters... The approach was thoughtfully objective throughout and it was particularly pleasing to note a more incisive recognition of factors that defy quantified expression." (Commander, US Army Vietnam-USARV, 29 November 1967)

"In general, I think it is becoming the best analytical periodical I've seen yet on Vietnam (though there's not much competition)." (MACV-DEPCORDS, 21 April 1967)

"Statistical extrapolations of this type serve an extremely useful purpose in many facets of our daily work." (CIA, 6 February 1967)

"One of the most useful Systems Analysis products we have seen is the monthly Southeast Asia Progress Report.... Indeed it strikes many of us as perhaps the most searching and stimulating periodic analysis put out on Vietnam." (President of The Rand Corporation, 22 October 1969)

In November 1968, 55 addressees answered a questionnaire about the Report: 52 said the report was useful, 2 said it was not, and 1 said, "The report does not meet an essential need of this headquarters;" nonetheless, it desired "to remain on distribution" for 7 copies. From 48 questionnaires with complete responses, we found that an average 4.8 people read each copy -- a projected readership of 500-950, depending on whether we assumed 1 or 2.4 readers of copies for which no questionnaire was returned.

Readers responding to the questionnaire reported using the Report for the following purposes:

Information	42%
Analysis	31%
Policy Making	11%
Briefings	7%
Other	9%
	<hr/> 100%

In addition, readers reported about equal interest in each of the seven subject areas normally covered in the Report.

VC/NVA	18%
Air Operations	20%
RVNAF	17%
Pacification	13%
Friendly Forces	12%
Deployments	12%
Logistics/Construction	8%
	<u>100%</u>

There was some negative reaction to the Report. Concern was expressed about "the distorted impressions" the Report left with the reader and its wide dissemination which "implies its acceptance by the Secretary of Defense, giving the document increased credibility."

Given the way in which the Southeast Asia Analysis Report was used, the important responsibilities of many of its readers, and the controversial aspects of the report, I decided to include in these twelve volumes every article ever published in a Southeast Asia Analysis Report. This will allow the users of these volumes to arrive at their own conclusions.

Thomas C. Thayer
February 18, 1975

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THE IMPACT OF OVERSEAS DOD EXPENDITURES FOR THE VIETNAM WAR ON
THE US BALANCE OF PAYMENTS

The adverse impact of Vietnam on the US Balance of Payments has been grossly overstated. The actual impact of DOD overseas expenditures for the war is only one-third of the figure usually given. Termination of the war will not eliminate the Balance of Payments deficit.

Overseas DOD expenditures for the war in Vietnam have been cited in several government publications as a major factor in the \$1.7 billion reduction (from \$7.0 billion in CY 65 to \$5.3 billion in CY 66) in the net balance of goods and services, "the trade balance." Net US military expenditures overseas last year increased by \$.7 billion, in spite of substantially increased military equipment sales in Western Europe. Since overseas expenditures for the Vietnam war were \$.9 billion in CY 66, they would appear to be responsible for about 50% of the decline in the US trade balance and 20% of the \$4.5 billion CY 66 deficit.

However, only about one-third of the additional overseas expenditures, \$.3 billion in CY 66, had an unfavorable impact on the US Balance of Payments. The remaining two-thirds are offset by increased US exports induced by raising the incomes and foreign exchange holdings of the recipient countries. The fraction of a dollar of additional DOD expenditures overseas for Vietnam returned as a purchase of US exports ranges from 1.00 for Japan to .40 for the Philippines. In Vietnam, where the largest expenditures occur, 66 cents out of every DOD dollar is returned to the US through the purchase of US goods and services.

The following table shows by country the distribution of US military expenditures for Vietnam (based on the DOD Comptroller's estimates), the induced US exports, and the net dollar drain for calendar 1966, 1967, and 1968.

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BALANCE OF PAYMENTS IMPACT ON OVERSEAS EXPENDITURES (\$ millions)

	CY '66			CY '67		
	(1) Net Dollar Drain (2)-(3)	(2) Addt'l DOD Expendi- tures Due to Vietnam	(3) US Exports Induced by DOD Expend- itures	(1) Net Dollar Drain (2)-(3)	(2) Addt'l DOD Expendi- tures Due to Vietnam	(3) US Exports Induced by DOD Expendi- tures
Vietnam	95.9	281.9	186.0	139.3	409.7	270.4
Ryukyus	--	28.5	28.5	--	38.7	38.7
Japan	--	107.2	107.2	--	153.9	153.9
Korea	16.0	64.0	48.0	24.7	98.8	74.1
Taiwan	20.4	40.8	20.4	32.9	65.7	32.8
Philippines	48.9	81.5	32.6	58.9	98.2	39.3
Thailand	53.3	108.7	55.4	70.8	144.4	73.6
Australia	?	1.5	.8	.7	1.3	.6
Canada	9.7	36.7	26.8	12.9	47.6	34.7
EEC Nations	6.1	12.1	6.0	8.5	17.1	8.6
All Other	28.3	56.6	28.3	42.4	84.8	42.4
POL (M.E.)	<u>50.4</u>	<u>126.1</u>	<u>75.7</u>	<u>57.6</u>	<u>144.0</u>	<u>86.4</u>
	329.9	945.6	615.7	448.7	1,304.2	855.5

CY POL estimated fr FY POL averages for years involved.

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CY '67			CY '68		
(2) Addt'l DOD Expendi- tures Due to Vietnam	(3) US Exports Induced by DOD Expendi- tures	(1) Net Dollar Drain (2)-(3)	(2) Addt'l DOD Expendi- tures Due to Vietnam	(3) US Exports Induced by DOD Expend- itures	
409.7	270.4	91.6	269.5	177.9	
38.7	38.7	--	20.0	20.0	
153.9	153.9	--	97.8	97.8	
98.8	75.1	15.2	60.7	45.5	
65.7	38.8	20.4	40.8	20.4	
98.2	39.3	38.3	63.8	25.5	
144.4	73.6	49.1	100.3	51.2	
1.3	.6	.1	.2	.1	
47.6	34.7	7.5	27.6	20.1	
17.1	8.6	.9	1.8	.9	
84.8	42.4	21.2	42.4	21.2	
<u>144.0</u>	<u>86.4</u>	<u>36.6</u>	<u>91.6</u>	<u>55.0</u>	
1,304.2	855.5	280.9	816.5	535.6	

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Highly restricted 1967

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IMPACT OF VIETNAM CONFLICT ON GREAT SOCIETY PROGRAMS

The Great Society is a combination of new programs (e.g., Civil Rights, Medicare, Office of Economic Opportunity) and the expansion of existing programs (increased Social Security benefits and wider eligibility, expansion of grants for education). To gauge the effect of Vietnam on the Great Society, it is necessary to compare the budget figures prior to and during the Vietnam crisis. Since the start of many new programs coincided with the Vietnam build-up, no attempt is made here to separate new from existing programs.

Increases in DoD spending impact mainly on non-defense purchases of goods and services, and especially those of the space program, for which the skills and production facilities are much the same; transfer payments and grants-in-aid to state and local governments, which comprise the bulk of Great Society expenditures, are least affected by increases in the level of DoD spending, since they are tied to long term commitments (Social Security) or economic conditions (unemployment compensation, farm program).

In toto, spending on the Great Society has increased at an average annual rate of 17.1% since FY 1965, while the rates for DoD and all Federal Government are 10.2% and 7.7%, respectively. (New Obligational Authority basis). Table 1 shows rates and levels for individual programs. Since the Vietnam build-up at the start of FY 1966, DoD and Great Society programs together will have accounted for almost 90% of the increase in the federal budget (Administrative Budget and Trust Fund Expenditure basis); Great Society programs alone account for 40% of the increase.

In FY 1957, DoD expenditures represented 53% of the total federal budget; in FY 1965, the year prior to the Vietnam build-up, they were 40.3% of the total, and in FY 1968 the figure will be 42.8%. For Great Society programs, the figures are 15%, 24.3%, and 28.9%, respectively.

Thus, the Vietnam situation has not reduced the growth rate of the Great Society programs. The related question, of course, is whether they would have grown even faster were it not for Vietnam. The answer to this question is a probable "yes"; but the total offset from a continued peace would have been (1) less than the increase in the DoD budget due to Vietnam, and (2) apportioned among non-Great Society programs, as well, especially the space program, for which funding has actually decreased every year since the Vietnam build-up.

On the other hand, the FY 1966 budget for Great Society expenditures (submitted prior to the build-up) fell short of realization by only \$752 million (2%), and expenditures in FY 1967 were estimated to exceed the budget submission by 5.1%, accounting for 23.2% of the announced FY 1967 deficit of \$9.9 billion.

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4

Further, for FY 1966-68, Great Society NOA has exceeded expenditures by an average of \$3.5 billion (21%) per year. The bulk of these funds is on a direct payment basis, and very little is for long lead-time items (e.g., construction); thus, expenditures should roughly equal NOA over time.* For the fiscal years 1957-65, NOA exceed expenditures for the Great Society programs by an average of almost one billion dollars, or 15%, per year. If the entire difference between NOA and expenditures were due to mid-year expenditure cutting by the Bureau of the Budget, recent cuts are only 40% higher, on a percentage basis, than those of the pre-Vietnam period, so that Great Society expenditures would be about \$1.4 billion (9%) higher without Vietnam.

*For comparative purposes, NOA has exceeded expenditures in DoD by an average of \$4.0 billion, FY 1965-68.

**NEW OBLIGATIONAL AUTHORITY AND ADMINISTRATIVE BUDGET AND
TRUST FUND EXPENDITURES, SELECTED ACCOUNTS, FY 1957-68 ^{a/}
(\$ Millions)**

	Fiscal Year					
	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>	<u>1962</u> <u>1963</u>
All Federal						
NOA	\$70,179	\$76,345	\$81,365	\$79,574	\$86,675	\$92,862 \$102,283
Exp.	81,904	86,694	99,863	97,751	104,308	112,928 119,187
National Defense						
NOA	40,365	40,512	45,586	44,832	45,994	52,414 54,323
Exp.	43,461	44,578	46,712	46,217	47,690	51,469 53,434
Space						
NOA	78	117	305	524	964	1,825 3,673
Exp.	76	89	145	401	744	1,257 2,552
Education						
NOA	671	597	626	969	1,333	1,285 1,420
Exp.	438	542	733	867	944	1,077 1,246
Anti-Poverty ^{b/}						
NOA	2,768	2,582	3,005	3,208	3,575	4,263 4,938
Exp. ^{c/}	2,234	2,554	2,917	3,140	3,391	3,890 4,491
Exp. ^{d/}	11,820	15,329	17,223	19,497	22,627	24,272 26,544
Urban Renewal ^{e/}						
NOA	313	467	338	501	3,069	231 238
Exp.	109	129	205	264	312	424 400
Civil Rights ^{f/}						
NOA			1	1	1	1 1
Exp.			1	1	1	1 1

^{a/} Source: The Budget of the United States Government, 1968.

^{b/} Account 650 - Health, Labor, and Welfare, excluding 652 Labor and Manpower.

^{c/} Excludes Trust Fund Account 650.

^{d/} Includes Trust Fund Account 650.

^{e/} Accounts 552, Public Housing and 553, Urban Renewal and Community Facilities.

^{f/} Includes Commission on Civil Rights; Civil Rights Education Activities, White House Conference; Civil Service Commission Administration of Voting Rights Act of 1965; Equal Employment Opportunity in Housing; President's Council on Equal Opportunity.

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AND
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Fiscal Year										Average Growth Rate (%)	
1960	1961	1962	1963	1964	1965	1966	1967	1968		FY 57-65	FY 66-68
9,574	\$86,675	\$92,862	\$102,283	\$101,103	\$106,608	\$126,139	\$139,562	\$143,994		4.8%	7.7%
7,751	104,308	112,928	119,187	126,569	126,144	141,842	167,611	179,540		4.9	9.3
4,832	45,994	52,414	54,323	53,762	53,198	67,364	75,108	77,851		3.2	10.2
6,217	47,690	51,469	53,434	54,668	50,914	58,478	71,360	76,857		1.9	10.9
524	964	1,825	3,673	5,100	5,250	5,175	4,968	5,050		60.0	-
401	744	1,257	2,552	4,171	5,093	5,934	5,600	5,302		60.0	1.0
969	1,333	1,285	1,420	1,530	2,417	4,315	4,623	5,245		15.3	21.5
867	944	1,077	1,246	1,341	1,546	2,836	3,300	2,785		15.0	15.8
3,208	3,575	4,263	4,938	5,204	6,670	8,572	10,481	11,727		10.2	15.2
3,140	3,391	3,890	4,491	5,036	5,333	7,074	9,896	10,778		10.2	19.3
9,477	22,627	24,272	26,544	27,769	28,518	33,458	41,373	47,888		10.3	13.9
501	3,069	231	238	236	1,110	1,462	1,322	2,201		15.1	18.7
264	312	424	400	455	650	679	824	1,264		21.9	18.1
1	1	1	1	1	13	16	21	34		n.a.	27.2
1	1	1	1	1	3	12	19	25		n.a.	50.0 +

1968.

652 Labor and Manpower.

and Community Facilities.

Education Activities, White House Conference on Civil Rights; Community Relations
Voting Rights Act of 1965; Equal Employment Opportunity Commission; Equal
Opportunity.

Excluded 1967

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The Cost of Bombing North Vietnam

The bombing of North Vietnam appears to cost the US about 9% of the \$24 billion total cost of the war in SEA. The table below shows these costs in terms of the incremental savings estimated for CY 1968 if U.S. air operations against North Vietnam were to be stopped. This is not to say that the bombing should be stopped - it is only an essential assumption in order to make a cost estimate.

INCREMENTAL SAVINGS - CY 1968 IF U.S. AIR OPERATIONS IN NVN ARE STOPPED (\$ Millions)

	<u>Operating Costs</u>	<u>Procurement Ammunition</u>	<u>Military Pay</u>	<u>Attrition</u>	<u>Pilot Costs</u>	<u>Total</u>
USAF Aircraft	148	253	125	417 <i>a/</i>	176 <i>b/</i>	1120
USN Aircraft	18	471	6	345 <i>c/</i>	18	858
USN Carriers	11	0 <i>c/</i>	12	0 <i>c/</i>	0	23
USA Personnel <i>d/</i>	28	5	33	0	0	66
USAF Personnel <i>d/</i>	43	0	49	0	0	92
	248	729	226	762	194	2159

a/ Includes \$26 million of USMC attrition.

b/ Includes \$1.4 million of USMC pilot costs.

c/ Included in cost of Navy aircraft.

d/ Base operating support and related support personnel.

If the air campaign against North Vietnam is stopped the U.S. would save approximately \$2.2 billion during CY 1968. Estimated savings in aircraft attrition (\$762 million) and ammunition (\$729 million) account for 59% of the total 2159 million. Pilot training costs would be reduced by approximately \$194 million because of lower training requirements and pilot losses. An additional \$248 million in operational expenses and \$226 million in military pay would be saved by reduced flying hours and munitions handling, closing of air bases and the phase out of the Intrepid.

These costs are based upon the SEAPRO Cost Analysis model which calculates the cost of alternative deployments in Southeast Asia. Cost factors in the model are based upon two states or conditions of military resources - deployed and not-deployed. These two states are roughly equivalent to wartime and peacetime conditions. This dual-state nature of the cost model makes it possible to calculate the incremental cost to deploy an infantry battalion (or a squadron of F4s) from a peacetime environment in the U.S. to a combat status and to operate it for a 12 month period in Southeast Asia. Wherever possible the cost factors have been based on the military cost handbooks and actual experience in Southeast Asia.

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Cost of U.S. Air Operations in NVN - Assumptions

The assumptions used to estimate the cost of U.S. air operations in North Vietnam during CY 1968 are shown below:

1. U.S. sorties planned for use in NVN were cancelled.
2. Planned sorties in Laos and South Vietnam were not changed.
3. Sufficient aircraft were left in South Vietnam to maintain air operations in SVN and Laos at their current level. All other aircraft were returned to the U.S. from Thailand and Navy aircraft carriers.
4. U.S. airbases in Thailand were closed whenever possible, and their base operating support personnel discharged from military service.
5. Two U.S. aircraft carriers were operated in a peacetime environment and the Intrepid was retired from the Navy.

Large numbers of Air Force and Navy aircraft could return to the U.S. if the U.S. air operations in North Vietnam are stopped. Without reducing the level of effort in South Vietnam and Laos, it would be possible to send all USAF fighter/attack, recce, and ECM currently stationed in Thailand to the U.S. The three Navy aircraft carriers at YANKEE STATION could be deployed to other areas of the world. Aircraft based in South Vietnam, no longer required to fly sorties in the North, would be used to offset the loss of these aircraft as shown below:

<u>Fighter/Attack Sorties in SVN/Laos Planned By</u>	<u>SVN/Laos Sorties</u>
USAF (Thailand-based)	12534
Navy	11401
Total	23935
<u>To Be Diverted From NVN</u>	
USAF (SVN-based)	20504
USMC (SVN-based)	7347
Total	27851
Difference	+3916
<u>Recce Sorties</u>	
Planned	4676
Diverted from NVN	4864
Difference	+188

It was assumed that two Navy aircraft carriers, currently operating in Southeast Asia, would be used for peaceful operations in other areas of the world. The Intrepid would retire from active service. The table below shows the Thailand-based aircraft which would return to the U.S. and operate in a peacetime environment. Propeller aircraft, B-52s, and F-102s were left in Thailand for use in other Southeast Asia military operations.

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<u>Type</u>	<u>Aircraft Returned to U.S.</u>
F-4	90
F-105	108
C-130	17
KC-135	40
RF-4	24
RF-101	16
EB-66	41
EC-121	6
Total	<u>342</u>

If these aircraft were returned to the CONUS it would be possible to close three U.S. airbases in Thailand (Ubon, Udorn, and Korat). This action would make it possible to remove approximately 6000 base operating support personnel from active duty. In addition, 4350 Army troops, used primarily in support of USAF operations in Thailand, could be discharged from the service.

7 Feb 68
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THE BOMBING - ITS ECONOMIC COSTS AND BENEFITS TO NORTH VIETNAM

I. Summary and Conclusion

One reason we bomb North Vietnam is to impose economic costs on the North Vietnamese for their continued support of the war in the South. These costs are imposed through destruction of North Vietnam's industry, transportation, communications, etc., and by forcing the government to divert productive labor from local production to bomb damage repair. (This paper does not consider other effects of the bombing on the North, such as adverse psychological effects on the population, creating fears of a wider war as an inducement to negotiate, and creating political divisions within the Government of North Vietnam that could lead to an early settlement).

Judged on this criterion, the air war on the North has not been very successful. The best statistical evidence available indicates that the results have been as follows:

- a. The total supply of goods in North Vietnam has been little affected by the bombing. Imports in the form of communist non-military aid have more than offset the loss of domestic production caused by the bombing. But, per capita consumption of consumer goods (food, clothing, etc.) is probably lower, because the composition of imports has been affected by military priorities.
- b. Much of North Vietnam's capital stock has been destroyed by the bombing. However, it could be replaced in a short period if the bombing stopped and if past or present levels of communist foreign aid continued. If the pre-bombing capital stock is replaced (but not increased), the "cost" of the bombing to North Vietnam would be the cumulative loss of output until full replacement occurs. Even if the pre-bombing capital stock were rebuilt but not increased, it would be more modern and productive than it otherwise would have been, thus offsetting part (if not all) of the bombing's cost.
- c. Manpower diverted from local production to bomb damage repair and military service (747,000) has been more than offset by the natural growth of the labor force, importation of foreign labor, labor released through bomb damage, etc., (841,000). North Vietnam has the ability to overcome future manpower shortages through a variety of methods such as diverting labor from low productivity employment (i.e., underemployment in agriculture), importing labor, and using more women in the labor force.

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- d. Some economic effects of the war on North and South Vietnam have been quite similar. In both countries, foreign aid has offset the loss of domestic production. The amount of aid to the two countries has been roughly proportional to the percentage of the labor force drawn into war activities.

II. Effects on North Vietnam's Gross National Product

Prior to 1965, the growth rate of the North Vietnamese economy averaged 6% per year. It is estimated that this rate continued (and even increased slightly) during 1965 and 1966, the first two years of the bombing (Table 1). In 1967, however, domestically-produced GNP declined sharply to only \$1,688 million - a level roughly comparable to the prewar years of 1963 and 1964. The cumulative loss in GNP caused by the bombing in the last three years is estimated to be \$294 million (Table 2).

To offset these losses, North Vietnam has had an increased flow of foreign economic aid. Prior to the bombing, economic aid to North Vietnam averaged \$95 million annually. Since the bombing began, the flow of economic aid has increased to \$340 million per year (Table 1). The cumulative increase in economic aid in the 1965-67 period over the 1953-64 averaged has been an estimated \$490 million.

Thus, over the entire period of the bombing, the value of economic resources gained through foreign aid has been greater than that lost because of the bombing (Table 3). The cumulative foreign aid increase has been \$490 million; losses have totaled \$294 million.

In addition to the loss of current production, North Vietnam has lost an estimated \$164 million in capital assets destroyed by the bombing. These capital assets include much of North Vietnam's industrial base - its manufacturing plants, power plants, and bridges.

It is not certain that Russia and China will replace North Vietnam's destroyed capital assets through aid programs, thus absorbing part of the bombing cost themselves. However, they could do so in a short period of time at relatively small cost; if economic aid remained at its wartime yearly rate of \$340 million and half were used to replace capital stock, North Vietnam's losses could be replaced in a year. If the capital stock is replaced, the economic cost to North Vietnam of the bombing will be the cumulative loss of output from the time the bombing began until the

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capital stock is fully replaced. Even this probably overstates the cost, however. Even if the pre-bombing capital stock were only replaced, it would be more modern and productive than it otherwise would have been.

While the aggregate supply of goods in North Vietnam has remained constant, standards of living may have declined. The composition of North Vietnam's total supply has shifted away from final consumer goods toward intermediate products related to the war effort, i.e., construction and transportation.

Food supplies, vital to the health and efficiency of North Vietnam, have been maintained with only a slight decline. As shown in Table 4, the estimated North Vietnamese daily intake of calories has fallen from 1,910 in 1963 to 1,880 in 1967. Even considering that imported wheat and potatoes are not traditional table fare in North Vietnam, the North Vietnamese are not badly off by past North Vietnamese standards or the standards of other Asian countries.

The output of industrial and handicraft output declined 35% in 1967 (Table 1). Economic aid has probably not replaced all of this decline. With lower war priority, the supply of non-food consumer goods such as textiles and durables has probably declined more than the food supply.

Despite lower standards of living, the ability of North Vietnamese government to sustain its population at a level high enough to prevent mass dissatisfaction is evident.

III. Effects on Total North Vietnamese Manpower Supply

In addition to the economic effects, the air war has drawn North Vietnamese labor into bomb damage repair, replacement of combat casualties, construction, transportation, and air defense. Over the last three years, these needs have absorbed almost 750,000 able-bodied North Vietnamese (Table 5).

But, again there are offsetting factors. First, over 90% of the increase in manpower has been provided by population growth (Table 5). Since the start of the bombing, 720,000 able-bodied people have been added to the North Vietnamese labor force.

Second, the bombing has increased not only the demand for labor but also the supply. The destruction of much of North Vietnam's modern industry has released an estimated 33,000 workers from their jobs. Similarly, the evacuation of the cities has made an estimated 48,000 women available for work on roads and bridges in the countryside. Both of these groups of people

CONFIDENTIAL

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were available for work on war-related activity with little or no extra sacrifice of production; if they weren't repairing bomb damage, they wouldn't be doing anything productive.

Third, North Vietnam has been supplied with manpower as a form of foreign aid. An estimated 40,000 Chinese are thought to be employed in maintaining North Vietnam's road and rail network.

Finally, additional workers could be obtained in North Vietnam from low productivity employment. In less developed countries, agriculture typically employs more people than are really needed to work the land, even with relatively primitive production methods. Also, further mobilization may be possible through greater use of women in the labor force. The available statistics are not precise enough to identify the magnitude of this potential labor pool, but the estimates given in Table 6 show that even after two years of war the total North Vietnamese labor force is only 54% of its population - scarcely higher than it was in 1965.

In sum, the total incremental need for war-related manpower of roughly 750,000 people appears to have been offset (Table 5) with no particular strain on the population. Future manpower needs may outstrip North Vietnamese population growth, but the North Vietnamese government can import more manpower (though there may be limits to how many Chinese they want to bring into the country), use women and/or underemployed workers, and draw workers from productive employment, replacing their output with imports. Given these options, it appears that the North Vietnamese government is not likely to be hampered by aggregate manpower shortages.

IV. Comparison of War's Economic Impact on North and South

Some economic effects of the war upon North and South Vietnam are quite similar. In both countries, prosecution of the war requires increased manpower and economic resources in non-productive activities, i.e., war. Domestic production declines because of the resulting destruction and disruptions. However, in both countries, the loss in domestic production has been offset by foreign aid.

In 1964, the South Vietnamese war-related employment absorbed 5.9% of its controlled population, whereas, North Vietnam absorbed 2.4% of its controlled population (Table 7). Even by 1967, North Vietnamese war employment absorbed only 4.9% of its population - a smaller percentage than South Vietnam did in 1964. In comparison, by 1967 the South Vietnamese government absorbed 7.1% of its controlled population, and it is having trouble maintaining this level.

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The greater the proportion of its country's manpower used in non-productive activity, the more economic aid has been brought in to compensate for lost production (Table 8). In 1967, foreign economic aid per government employee was \$360 in the North - where 4.9% of the population was absorbed by war activities - and \$563 in the South - where 7.1% of the controlled population was absorbed. This implication is that economic aid has been roughly proportional to the percentage of the population drawn into war activities.

CONFIDENTIAL

15

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TABLE 1

NVN AGGREGATE OUTPUT + ECONOMIC AID ^{a/}
(Current. \$ Million)

	Industry & Handi- crafts ^{b/}	Agri- culture ^{c/}	Construction ^{d/}	Commerce & Trans- portation ^{e/}	Domestic ^{f/} Production	Foreign Economic Aid	Total NVN Supply
1963	\$599	\$600	\$193	\$240	\$1,632.	\$95	\$1,728
1964	673	625	206	258	1,763	95	1,859
1965	731	654	265	290	1,941	150.	2,091
1966	739	613	354	319	2,026	275	2,301
1967	480	572	354	281	1,688	340	2,028

^{a/} No NVN estimates of gross material product exist for 1966 or 1967. The figures shown represent estimates made using available information.

^{b/} 1963-1966 estimates are official NVN data. 1967 estimate was derived by estimating the functioning capacity of each industry and its related output. Source: NIS, Chapter 43, Section 6.

^{c/} The 1963-67 estimates are based on the total calories produced by NVN agriculture and a dollar per calorie estimate of their value. Source: Intelligence Note #868, Department of State.

^{d/} The 1963-66 estimates are official NVN data. It is assumed that the value of construction remained unchanged from 1966 to 1967. Source: NIS, Chapter 43, Section 6.

^{e/} The 1963-1964 estimates are official NVN data. The 1965-67 values were computed by assuming a constant ratio between total value of goods supplied and the value of their distribution and transportation. Source: NIS, Chapter 43, Section 6.

^{f/} The NVN term for domestic production is "gross material production". As this implies, it excludes non-material output such as services and does not net out depreciation of the capital stock.

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TABLE 3

COST AND BENEFITS OF THE BOMBING Cumulative 1965 - 1967

	<u>Benefits</u>	<u>Costs</u>
Incremental Foreign Aid	\$490 ^{a/}	Expected Growth and Current Production Foregone
		\$294 ^{b/}
		Capital Losses
		164 ^{c/}
Total	\$490	\$458

^{a/} Cumulative foreign aid, 1965-67, over and above the 1954-64 average of \$95.6 million per year.

^{b/} See Table 2.

^{c/} An Appraisal of the Bombing of NVN, CIA, October 1967. Capital losses include bridges and other transport facilities, transport equipment, electric power plants, manufacturing facilities, petroleum, and miscellaneous assets. The losses are valued at U. S. dollars replacement cost using Asian factor costs and proportions.

CONFIDENTIAL

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TABLE 4
NVN's FOOD SUPPLY ^{a/}

	Per Capital Daily Calories ^{b/}			Grams of Proteins Per Day ^{c/}
	<u>1959</u>	<u>1963</u>	<u>1967</u>	
North Vietnam				
Domestic	1,965	1,910	1,650	
Imported	-	-	230	
Total	1,965	1,910	1,880	42.7
Ceylon	2,030	1,920		42.0
Taiwan	2,330	2,380		60.0
India	1,900	1,940		50.0
Philippines	1,760	2,000		46.0

^{a/} NVN estimates from Intelligence Note #868, Department of State, November 1967.

^{b/} Source of estimates for countries other than NVN came from Statistical Yearbook - 1965, United Nations, N. Y. C.

^{c/} 1967 estimates for NVN, 1964 estimates for other countries.

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TABLE 5

SOURCES AND USES OF WAR-RELATED MANPOWER ^{a/}
(People Aged 15-64 in 000)
January 1965 - December 1967

<u>Sources</u>		<u>Uses</u>	
Natural Additions to Civilian Labor Force ^{b/}	720.0	Killed in NVN	25.0 ^{f/}
Foreign Workers ^{c/}	40.0	Killed in SVN	61.0 ^{g/}
Evacuated Employables ^{d/}	48.0	Increase in Armed Forces	275.0 ^{h/}
Bombing Released ^{e/} Industrial Workers	33.0	Total Bomb Damage Repair	200.0 ^{i/}
Industrial and Agri- cultural Workers Released by Imports	Unknown	Construction	65.0 ^{i/}
		Transportation	135.0 ^{j/}
		Increase in Transportation	146.0 ^{j/}
		Foreign Workers in Bomb Repair and Transportation	40.0
Total	841.0		947.0

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TABLE 5, Continued

SOURCES AND USES OF WAR-RELATED MANPOWER ^{a/}
(People Aged 15-64 in 000)
January 1965 - December 1967

Footnotes

- a/ Excludes part time workers (about 150,000 in bomb damage repair, 25,000-30,000 in air defense).
- b/ Civilian labor force is assumed to be 51.4% of the population. Population will increase from 17,950 million in January 1965 to 19,300 million in December 1967. Source: DIAAP 475-2-2-67-INT.
- c/ CIA staff estimate - December 1967.
- d/ Of 190,000 total evacuees from Hanoi and Haiphong, it is assumed that 50% are women of working age and half of those are employable on war activities. Source: DIA 4B-7335-14.
- e/ All of the decline in industrial employment (see Table 6) is attributed to the bombing.
- f/ These estimates by the CIA staff include civil and military casualties through December 1967. Between 19,000 and 23,000 NVN were killed from January 1965 through June 1967.
- g/ Includes killed, died of wounds, and defectors. Source: Southeast Asia Statistical Tables, OASD(SA).
- h/ Includes about 135,000 in air defense.
- i/ CIA staff estimate.
- j/ See Table 6. Total increase in manpower employed in transportation is 281,000 - the sum of men in repair activities (135,000) and transportation (146,000).

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TABLE 6
NVN EMPLOYMENT ^{a/}

	(Thousands)	
	January 1965	January 1967
<u>Production and Distribution</u>		
Agriculture	6,900	7,000 ^{b/}
Industries	350	817
Construction	185	250
Transportation & Communication	145	426
Trade & Other	350	366
Subtotal	8,430	8,859
<u>Services</u>	770	841
Total Civilian Labor Force	9,200	9,700
Military	200	475
<u>Total Labor Force</u> ^{c/}	9,400	10,175
Population	17,950	18,850

^{a/} DIA staff estimate.

^{b/} Includes some workers in war-related activities.

^{c/} Excludes unfit, students, unemployed, and members of the population younger than 15 and older than 64.

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TABLE 7

WAR EMPLOYMENT - NVN AND SVN

	Employment (000)		% of Population	
	January 1965	December 1967	January 1965	December 1967
<u>NVN</u>				
Military ^{a/}	200	475	1.1%	2.5%
Government ^{b/}	230	270	1.3	1.4
Bombing Repairs	0	200	0	1.0
	—	—	—	—
Total War Sector	430	945	2.4%	4.9%
Population	17,950	19,300		
<u>SVN</u>				
Military ^{a/}	612	724	4.8	4.9
Government ^{c/}	142	192	1.1	1.3
U.S. Employees	5	129	0	.9
	—	—	—	—
Total War Sector	759	1,045	5.9%	7.1%
Controlled Population ^{d/}	12,804	14,750		

^{a/} Estimates include all armed and uniformed soldiers. For SVN, this figure includes ARVN, RF, CIDG, and National Police. Source: Southeast Asia Statistical Bulletin, October 1967.

^{b/} Estimates include all employees in non-productive elements of socialist sector. It includes NVN government employees in industry, agriculture, construction and forestry. Source: DIA AP-475-2-2-67-INT.

^{c/} Source: Annual Statistical Bulletin, USAID, Saigon 1967.

^{d/} Controlled population is assumed to consist of the sum of GVN-controlled and contested population. The VC-controlled population in SVN is excluded because the GVN will be unable to obtain employables from it in large numbers.

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TABLE 8
FOREIGN ECONOMIC AID - NVN AND SVN ^{a/}

	<u>1964</u>	<u>1967</u>
Foreign Aid (\$ Million)		
SVN	\$225	\$578
NVN	95	340
War Employment (000)		
SVN	759	1,045
NVN	430	745
War Employment as Percent of Population		
SVN	5.9%	7.1%
NVN	2.4	4.9
Foreign Aid Per War Employee (\$/Man)		
SVN	302	553
NVN	220	359

^{a/} Excludes all military aid. MIS, Chapter 43, Section 6 is source of NVN data. Annual Statistical Bulletin, USAID, Saigon 1967 is source of aid estimates for SVN.

CONFIDENTIAL

CONFIDENTIAL

Aug 68

COST OF THE VIETNAM WAR

We estimate the incremental cost of the Vietnam war for FY1969 to be \$22.9 billion (Table 1). By incremental costs we mean only those costs which are specifically attributable to the war. This includes, for example, the difference between peacetime and wartime costs for units in SEA which are part of the baseline force structure and the total cost of units and individuals which are added on to the force structure because of the war. Wherever possible, data based on current projections of actual consumption (e.g., attrition of aircraft and other equipment, ammunition consumption) were used to arrive at the final estimates. Once the war ended and U.S. forces returned to their programmed peacetime force levels, this total -- less an estimated \$300-400 million which is properly force modernization (primarily aircraft replacement) -- indicates the savings which could be achieved.

Table 1
Cost of the Vietnam War
(FY 1969 - \$ billions)

	<u>Procurement^{a/}</u>	<u>Ammunition</u>	<u>Operating Costs</u>	<u>Personnel</u>	<u>Total</u>
USA	1.4	2.0	4.0	3.2	10.6
USAF	.9	1.9	1.5	.8	5.1
USMC	.5	.7	.7	.5	2.4
USN	.5	.5	.7	.7	2.5
RVNAF/FWF Support	.7	.7	.8	.1	2.3
	<u>3.9</u>	<u>5.8</u>	<u>7.7</u>	<u>5.4</u>	<u>22.9</u>

a/ Includes Military Construction.

Note: All numbers are rounded off to the nearest \$100 million; thus sums of rows or columns do not necessarily equal totals.

Our estimate differs from previous estimates for several reasons:

- (1) The force structure has stabilized in FY1 with no major build-up occurring. Thus, estimates based on projections from previous years tended to overstate actual costs.
- (2) Previous estimates charged costs to the war which would have been incurred in peacetime anyway.
- (3) Some aspects of the war have become less costly, e.g., air operations over NVN and bomb procurement.
- (4) Previous estimates were simply exaggerated.

The estimates were made primarily with the use of the SEA dual-state force planning model, which was developed by Research Analysis Corporation and improved by OASD(SA) SEAPRO. The model, in contrast to traditional budgetary methods, (such as the use of per man averages) permits cost analysis of a great variety of deployments. This provides more accurate cost estimates since ammunition consumption, equipment attrition, and operating costs, etc. vary widely among different types of units. On the other hand, some costs -- such as CONUS SEA-related costs -- are difficult to measure and may be understated. Nevertheless, we believe that these are the most accurate estimates of the cost of the war produced thus far.

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Table 2 shows that ground operations account for approximately 55% of the cost of the war while air operations account for approximately 30%. Given the present bombing policy, we can expect to spend approximately 27% more for air operations outside of SVN (NVN, Laos, IGLOO WHITE, and 10% of B-52 costs) than for air operations in-country (SVN and 90% of B-52 costs) in FY1969.

RVNAF/FWF support accounts for approximately 10% of the cost of the war. An estimated 6.8% (\$1.55 billion) of the total is for the RVNAF alone (including \$500 million for force modernization).

Additional personnel in CONUS account for approximately 14% of the cost of the war. This includes an estimated 100,000 additional transients, 160,000 additional trainees and students, and 60,000 additional personnel in the training establishment as a result of the war.

Table 2
Cost of the Vietnam War by Function
(FY 1969 - \$ millions)

	<u>USA</u>	<u>USAF</u>	<u>USMC</u>	<u>USN</u>	<u>RVNAF/FWF</u>	<u>Total</u>
<u>Air Operations</u> ^{b/}						
NVN	-	1030	77	952 ^{c/}	-	2059
SVN	-	1439	351	45	165	2000
Laos	-	635	12	74	85	806
B-52	-	904	-	-	-	904
IGLOO WHITE ^{d/}	311	295	-	26	-	632
Transport ^{e/}	-	387	5	-	-	392
<u>Ground Operations</u>						
Combat	3673	-	1016	-	1515	6204
Combat Support ^{f/}	2454	-	476	681	100	3711
Others ^{g/}	1794	-	168	239	470	2671
<u>Construction</u> ^{h/}	150	75	-	75	-	300
CONUS SEA-Related ^{i/}	2181	288	300	410	-	3179
	10,563	5053	2405	2502	2335	22,858

a/ Amounts for RVNAF/FWF are current estimates, subject to revision pending proposed policy changes.

b/ Costs per country (NVN, SVN, Laos) are based on OASD(SA) estimate of sortie distribution, FY1969.

c/ Includes an estimated \$30 million for SEA DRAGON.

d/ Current requirements, FY1969; amounts by service include proportional shares of \$17 million for DCPG.

e/ Intra-theater transport only.

f/ Non-divisional artillery, aviation (RW only for USMC), engineers, and signal units for USA and USMC; naval gunfire support, patrol boats, Riverine Force, and NMCB for USN.

g/ Support (MACV, 1st Log Com, 44th Med Bde, NSA, etc.) in RVN; amount for USA also includes incremental units and personnel since 1965 in Japan, Okinawa and Thailand.

h/ Military construction only.

i/ Incremental trainees, training establishment, patients, transients, BOS, etc.

CONFIDENTIAL

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Dec 68

RVNAF AND US ADVISORY COSTS FY 65 - FY 67

A recent RAC study has analyzed the costs of RVNAF ground forces for FY 65 through FY 67.^{1/} The resources for support of RVNAF ground operations during the 3 year period studied came from the following sources: (1) the DOD military assistance program, until March 25, 1966 when the MAP program for RVN shifted to service funding; (2) the US Army appropriations; (3) the US economic assistance programs under the auspices of AID; and (4) the RVN governmental appropriations (defense budget).

Table 1 indicates that the US paid 60% of the \$2 billion of RVNAF costs during the period, but its share declined from 64% in FY 65 to 58% in FY 67. RF and PF expenditures doubled during the period and accounted for a larger share of the total budget each year; RF went from 10% to 17% of the total, PF from 7% to 11%.

TABLE 1
COSTS OF ARVN, RF AND PF
(\$ million)

	<u>FY 65</u>	<u>FY 66</u>	<u>FY 67</u>	<u>Total</u>
<u>Financial Sources</u>				
US: Military Assistance ^{a/}	245.5	284.9	239.9	770.3
Support of RVN Defense Budget	115.0	148.8	189.2	453.0
TOTAL	350.5	433.7	429.1	1223.3
RVN Total	198.5	304.2	317.0	819.7
GRAND TOTAL	559.0	737.9	746.1	2043.0
<u>Expenditures</u>				
ARVN	460.9	552.5	535.2	1548.6
RF	58.2	113.0	128.9	300.1
PF	39.9	72.4	82.0	194.3
TOTAL	559.0	737.9	746.1	2043.0

^{a/} Derived from US economic assistance programs under the auspices of AID.

The RVN Army

The estimated direct total cost of support of the RVN Army for FY 65 - FY 67 is \$1.5 billion of which 49% was expended for materiel and maintenance; 43% for

^{1/} Resource Allocations for the RVN Army, Regional Forces, Popular Forces and US Advisory Program.

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pay and allowances, and 8% for other expenses. (See Table 2 for yearly expenditures.) The direct cost was 42.8% US military funded, 32.9% RVN funded, and 24.3% US support of RVN defense budget funded. The estimated average annual per capita cost of the ARVN was \$2,027 during the period.

TABLE 2

COSTS OF ARVN (\$ million)

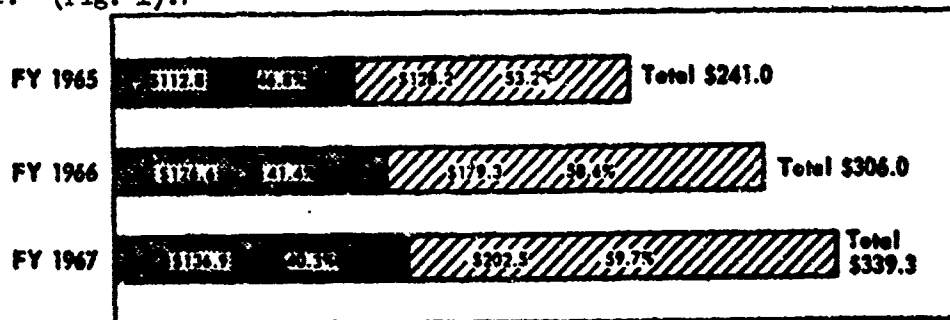
	FY65	FY66	FY67	Total
Pay and Allowances	180.7	233.6	257.3	671.6
Materiel and Maintenance:				
Ammunition a/	74.0	128.0	89.2	291.2
Weapons	15.1	4.2	5.1	24.4
General Supplies a/	42.1	38.9	28.0	109.0
RVN Defense Budget	29.9	40.4	50.9	121.2
Maintenance b/	0.7	0.1	0.1	.9
Other c/	83.9	67.1	60.7	211.7
Total	245.7	278.7	234.0	758.4
Construction	5.3	13.1	18.6	37.0
Maintenance of Facilities	11.1	10.5	10.7	32.3
Other Expenditures	18.1	16.6	14.6	49.3
TOTAL	460.9	552.5	535.2	1548.6

a/ Exclusive of supply operations.

b/ All funded by US support of RVN defense budget.

c/ Includes combat, support, and tactical vehicles, communications and other support equipment, supply operations, and rehabilitation.

The Republic of Vietnam proportion of the financial support of the RVN Army increased each year. The absolute amount of US support increased at a slower rate. (Fig. 1)..

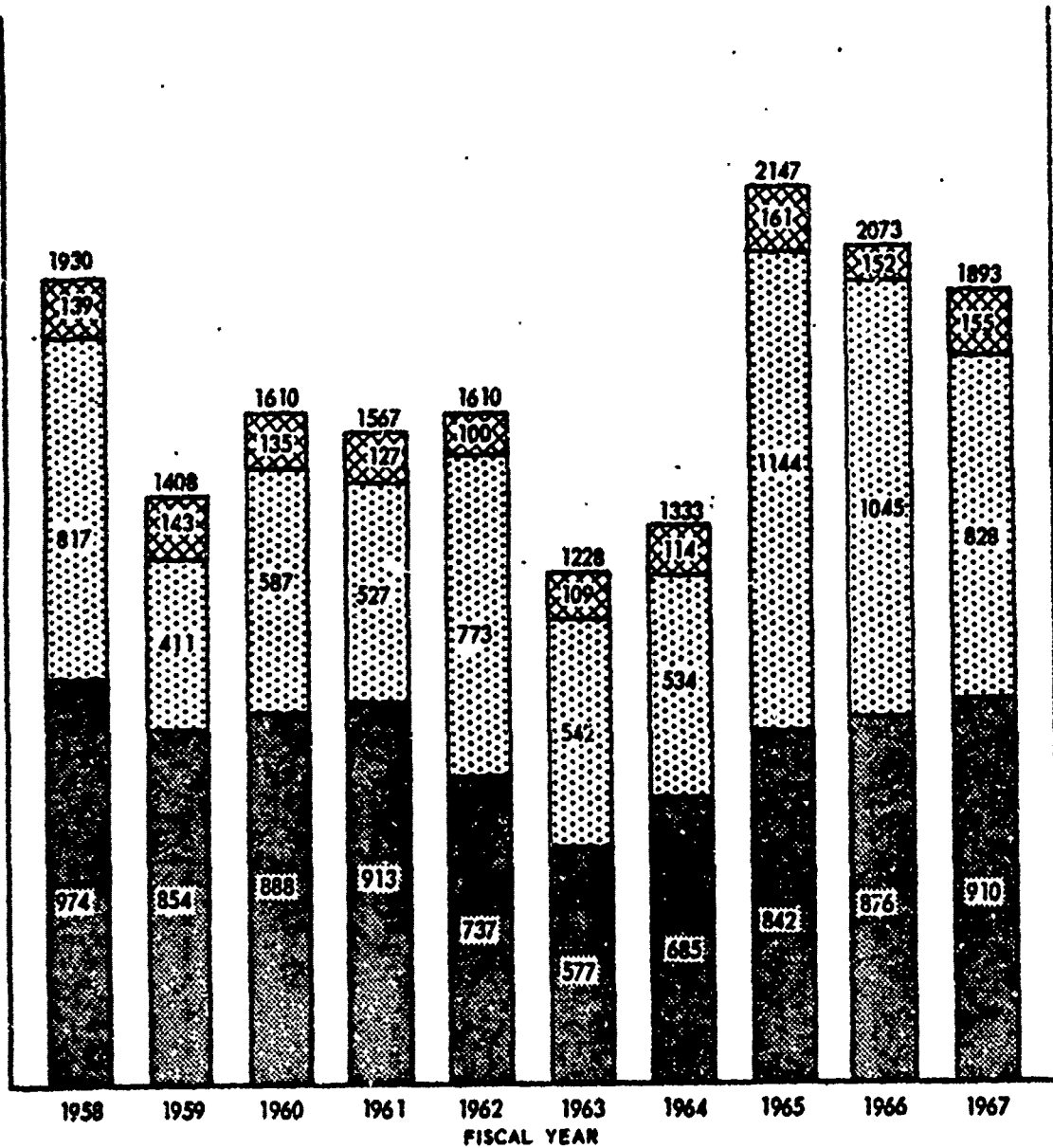


(C) Fig. 1 — Estimated RVN Defense Budget for the RVN Army
(in millions of dollars)

■ US ▨ RVN
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The total average annual per capita cost remained quite stable throughout the period FY 58 - FY 67 despite sharp increases in the total annual cost of support of the RVN Army (see Figure 2). The major variable in the annual per capita cost is the rise in cost of pay and allowances due to the general increase in pay scales and the introduction of a cost-of-living factor.



(C)

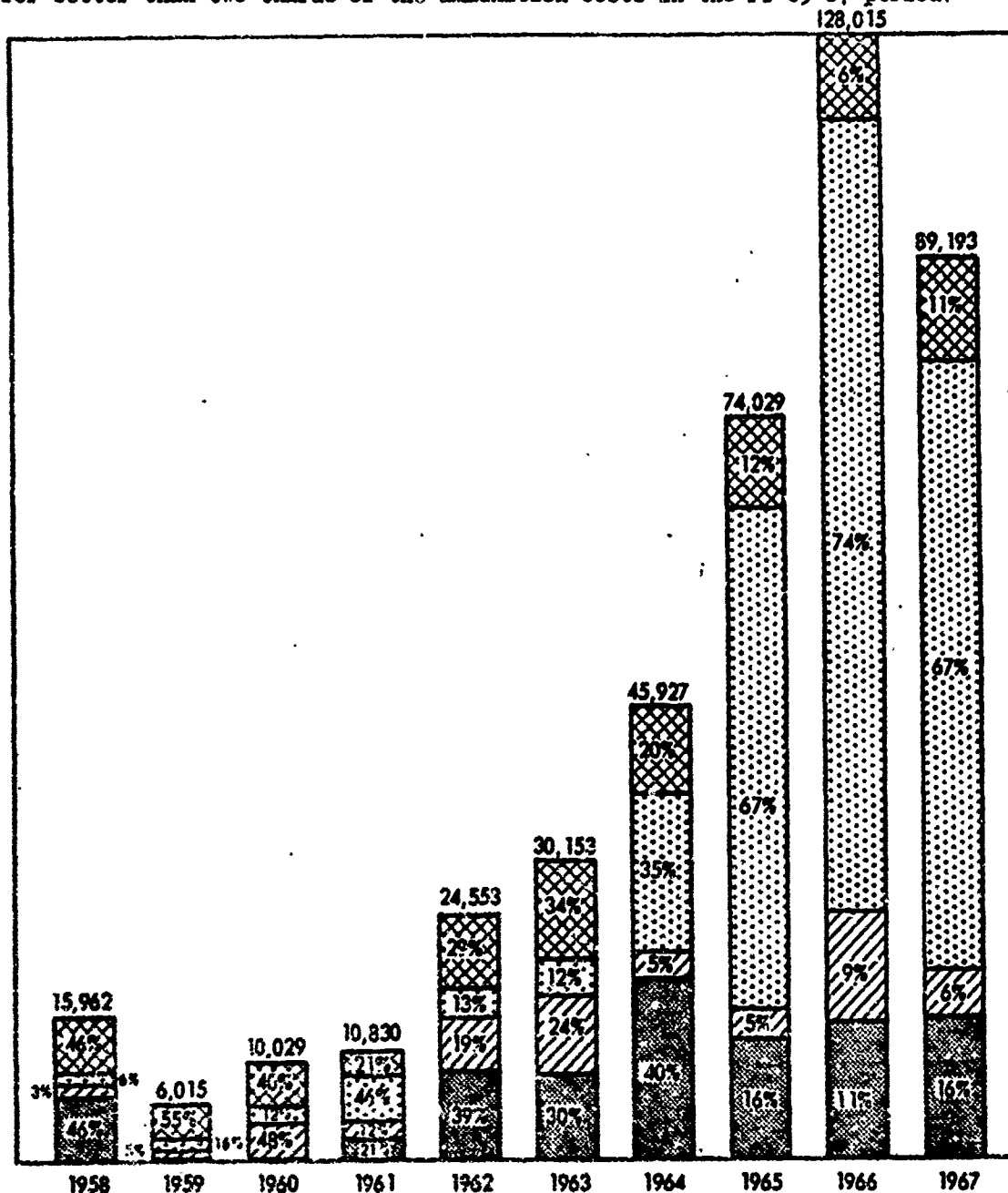
Fig. 2 — Total RVN Army Annual Per Capita Cost
(in dollars)

Other cost Materiel & Maintenance Pay & allowance

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The major variation within materiel and maintenance costs over the 10-year period FY 58 - FY 67 was the expenditures on ammunition, which parallel the increased intensity of combat in the RVN. (see Figure 3). Artillery accounted for better than two-thirds of the ammunition costs in the FY 65-67 period.



(C) Fig. 3 —Estimated Total Ammunition Expenditures, FY58-67
(in thousands of dollars)

Other Artillery 60-mm and 81-mm mortar Small Arms

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Regional Forces and Popular Forces

During the period FY 65 - FY 67, the total expenditures for both the Regional Forces and the Popular Forces increased steadily to an estimated total cost of \$300.1 million for the Regional Forces and \$194.3 million for the Popular Forces. In the Regional Forces 70% of the total cost went for the pay and allowances, 26% for materiel and maintenance, and 4% for other costs. In the Popular Forces 72% of the total cost accounted for pay and allowances, 27% for materiel and maintenance and 1% for other costs. (See Table 3.)

TABLE 3

ESTIMATED COST OF REGIONAL FORCES AND POPULAR FORCES a/ b/ (\$ million)

	<u>FY65</u>	<u>FY66</u>	<u>FY67</u>	<u>Totals</u>
<u>Regional Forces</u>				
Pay and Allowances	36.0	83.0	95.7	214.7
Materiel and Maintenance	21.3	24.6	25.7	71.6
Other	0.9	5.4	7.5	13.8
TOTAL	58.2	113.0	128.9	300.1
<u>Popular Forces</u>				
Pay and Allowances	25.9	52.0	64.2	142.1
Materiel and Maintenance	13.5	19.4	17.0	49.9
Other	0.5	1.0	0.8	2.3
TOTAL	39.9	72.4	82.0	194.3

a/ In millions of dollars.

b/ All data from I. Heymont, Resource Allocations for the RVN Army, Regional Forces, Popular Forces, and US Army Advisory Program: FY65-FY67.

The estimated average annual per capita cost is \$803.7 for the Regional Forces, and \$454.3 for the Popular Forces.

The cost of the Regional Forces was 57% RVN funded, 24% US military funded, and 19% US support of RVN defense budget funded. The cost of the Popular Forces was 71% RVN funded, 19% US military funded and 10% US support of RVN defense budget funded. The increased US interest in raising the effectiveness of the Regional Forces and the Popular Forces during the period is reflected by the greater amounts of assistance each year both in military assistance and in support of the RVN defense budget for those forces. When the US support increased in FY 66 and FY 67, RVN support (see Table 4) for the RF/PF decreased somewhat in FY 67.

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TABLE 4

RF AND PF COSTS BY FUNDING SOURCE (\$ Million)

	<u>FY65</u>	<u>FY66</u>	<u>FY67</u>	<u>Total</u>
<u>Regional Forces</u>				
US: Military Assistance	17.5	24.5	29.3	71.3
Support of RVN Def Budget	.2	18.3	37.7	56.2
Total	17.7	42.8	67.0	127.5
RVN Total	40.6	70.2	61.8	172.6
Grand Total	58.3	113.0	128.8	300.1
<u>Popular Forces</u>				
US: Military Assistance	9.1	15.0	23.4	47.5
Support of RVN Def Budget	1.2	2.8	6.0	10.0
Total	10.3	17.8	29.4	57.5
RVN Total	29.7	54.6	52.6	136.9
Grand Total	40.0	72.4	82.0	194.4

Several observations can be made for the period FY 58 - FY 67. Until FY 64 the total cost of the Regional Forces remained fairly constant with most of the financial resources provided by the RVN. Consistent US support first became significant in FY 64 and the level of such support increased sharply in FY 66 and FY 67, reflecting the growing concern of the US in increasing the effectiveness of the Regional Forces. The annual per capita cost of the Regional Forces has been quite stable except for FY 63. The largest variable in the annual per capita cost of the Regional Forces, as in the case of the RVN Army but to a greater degree, is pay and allowances.

Until FY 62 the Popular Forces were completely supported by the RVN. US support of the Popular Forces has increased consistently since its start in FY 63 and reached 36% of the total in FY 67, but was considerably less than the US support extended to the Regional Forces and the RVN Army. The largest variable in the annual per capita cost is pay and allowances.

US Army Advisory Program

The available data on expenditures in support of the US Army advisors for FY 65 - FY 67 are incomplete, however; the identified expenditures total \$67 million - \$8 million for pre-deployment training, \$25 million for deployment costs, \$8 million for military assistance materiel, and \$26 million for in-country expenses. (The validity of these expenditure data is considered to be poor.)

Until 1962 there were relatively few field advisors. Detailed data on assignment of field advisors did not become available until late in FY 64. The data show that in FY 63 and FY 64 the ratio of the average number of field advisors in the RVN per 1000 assigned RVN Army strength was about the same as FY 65 - FY 67. At the end of FY 67 the number of advisors per 1000 assigned strength averaged about 12 for divisions, 11 for Ranger units, 21.2 for Armor units, and 0.8 for RF/PF.

CONFIDENTIAL

69

CONFIDENTIAL

COST OF THE WAR IN VIETNAM

Summary. Our latest estimate of the yearly incremental cost of the war in terms of resources consumed is \$17.6 billion, about 20% lower than a year ago. The equivalent incremental FY 1970 budget figure is only about \$15.6 billion. The "total" cost of the war is about \$27 billion in terms of resources consumed and \$24 billion in FY 1970 budget terms. The announced budget cutbacks would reduce the incremental budget cost of the war to about \$12.8 billion under current assumptions. Analysis of the war by mission reveals that over half of the resources go to offensive activities; most (27%) of the remainder is spent for interdiction. Land operations account for about two-thirds of the incremental cost of the war; air and offshore operations account for the rest.

How Costs are Estimated. Current estimates of the cost of the war in Vietnam range from \$15 to \$27 billion per year. Some of the variations result from the use of different cost and activity factors, but the differences stem primarily from different approaches to calculating costs and different concepts of costs. Some estimates of the cost of the war are calculated on the basis of current consumption requirements while others are related to a particular year's defense budget. The consumption estimates are based on the resources actually being consumed in the war. The budget estimates differ insofar as the budget in any one fiscal year is affected by special circumstances (e.g., added procurement during the build-up phase or one-time savings such as occurred in aircraft procurement after the decision to stop bombing North Vietnam).

Under either basic approach to estimating the cost, at least two different cost concepts can be used. One is the total cost concept. It results in an estimated war cost of about \$27 billion under the "current consumption" approach and about \$25 billion under the budget approach. Comparable figures a year ago were \$32 billion and \$30-31 billion. The total cost concept charges the entire cost of operating our forces in Southeast Asia to the war, even though some of these costs would be incurred in peacetime, e.g., pay and allowances for forces in the peacetime baseline and ammunition, fuel, and parts used in training. A more meaningful concept is incremental or marginal cost. This looks only at the "added" costs incurred because of the war; these are the costs that should disappear when the war ends. It represents, therefore, the difference between the total current DOD program and the one for the peacetime force structure after the war.

A third cost concept is reflected in the figures the Defense Department Comptroller provides to the Congress, which are a mixture of full and incremental costs. Incremental costs are used to calculate personnel and major procurement costs, but a full cost approach is applied to operating costs. For this reason the Comptroller estimates (\$28 billion for FY 69 and about \$22 billion for FY 70) have been consistently higher than our estimates of incremental costs.

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Incremental Costs of the War. Table 1 shows our estimates of the incremental cost of the war on the basis of consumption rates and deployed forces over the past 6-12 months and the funds in the FY 70 budget. These could be considered the annual costs as of about June 1969. The \$17.6 billion figure is our best estimate of the resources that would be released if the war ended last June. This figure was about \$23 billion a year ago, but reduced combat intensity and the NVN bombing halt reduced the cost by about 20%.

TABLE 1

ESTIMATED INCREMENTAL COST OF THE VIETNAM WAR BY MAJOR BUDGET CATEGORIES^{a/} (\$ Billions)

	<u>Consumption Costs</u>	<u>FY 70 Budget (TOA)</u>
Military Personnel	5.2	5.2
Operations (O&M)	6.8	6.6
Procurement-Non-munitions	2.0	1.1
Procurement-Munitions	3.4	2.5
RDT&E	0.1	0.1
Military Construction	0.1	0.1
Total	<u>17.6</u>	<u>15.6</u>

a/ Before any announced reductions in force levels (including 703 cuts).

Table 2 reduces the cost figure of \$17.6 billion to the FY 70 budget level of \$15.6 billion and then shows the further reductions resulting from the approved force redeployments and the Project 703 budget reductions. Annual savings from the Project 703 budget cuts and the two phases of troop redeployments announced amount to \$2.8 billion, reducing the incremental budget cost of the war to \$12.8 billion.

TABLE 2

ESTIMATED INCREMENTAL VIETNAM WAR COSTS (\$ Billions)

	<u>Annual Basis</u>	<u>FY 70</u>
Current Consumption Costs ^{a/}	17.6	17.6
Less: Excess of Current Consumption over Budget	2.0	2.0
Budget for War Before Phase 1 Redeployments	15.6	15.6
Less: TOA Savings of first 25,000 redeployment	0.2	0.2
Budget Cost After First Redeployment	15.4	15.4
Less: 703, SEA-related TOA cuts, in addition to savings from the first redeployment	2.6	1.5

Budget Cost After Announced Cutbacks	12.8	13.9
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a/ Based on FY 69 consumption data and latest production costs for equipment and munitions.

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Table 3 shows the allocation of the resources between major missions and activities in percentage terms. About two-thirds of the resources are used in land operations, with the rest allocated mainly to air operations. In terms of major missions conducted by allied forces, over half of the cost of the war goes for offensive activities, a quarter for interdiction, and the remaining 15% for defensive activities, pacification, and national development. The resources allocated to pacification are particularly important. While the amount is still very small (only 8%), it is larger than in previous years.

TABLE 3

FY 70 ESTIMATED INCREMENTAL COST OF THE WAR
BY MAJOR MISSIONS AND ACTIVITIES a/
(Percent)

	Inter- diction ^{b/}	Offensive Activities	Military Security & Defensive Activities	Pacifi- cation	National Develop- ment	Total
Land Operations	2	76	9	12	1	100
Air Operations	a/ 84	14	2	-	-	100
Offshore Operations	44	56	-	-	-	100
Total Military Activities	27	58	6	8	1	100

- a/ Offshore operations include naval gunfire support and patrolling of the coastline in order to interdict the infiltration of enemy men and supplies from the sea. Carrier operations are included under air.
- b/ This mission includes mainly the air activities over Laos and South Vietnam and operations off the coastline that seek to deny external assistance to the enemy forces in SVN by attacking the infiltration routes and the men and materiel moving over them.
- c/ The allocation to major missions, except interdiction and national development, is based primarily on battalion days of operation during the last three months.

Table 4 compares in dollar and percentage terms the allocation of resources to the major activities of land, air, and offshore operations under the "current consumption" and budget approaches, and under the budget approach when the full 703 cuts are taken out. It shows that the allocation of the cost of the war between major activities is almost identical under either the "current consumption" or budget methods of calculating the cost of the war. The 703 cuts, however, affect land operations more than the other activities, slightly reducing its share of the cost of the war while increasing that of air operations. (Tables 5, 6, and 7 provide a more detailed breakdown of the figures.)

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TABLE 4

ESTIMATED INCREMENTAL COST OF THE WAR BY MAJOR ACTIVITY (\$ Billions)

Activity	FY 70 Current Consumption ^{a/}		FY 70 Budget (TOA) ^{a/}		Budget Cost After 703 Cuts ^{b/}	
	\$	%	\$	%	\$	%
Land Operations	11.5	65	10.3	66	8.1	63
Air Operations	4.9	28	4.4	28	3.9	30
Offshore Operations	0.9	5	0.6	4	0.5	4
Other	0.3	2	0.3	2	0.3	3
Total	17.6	100	15.6	100	12.8	100

a/ Before any withdrawals.

b/ This is the FY 70 budget (TOA) adjusted for the full annual impact of the Project 703 cuts (\$2.8 billion). The impact of these in FY 70 is only about \$1.7 billion because they will be effective for only part of the fiscal year.

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TABLE 5

**FY 70 ESTIMATED INCREMENTAL CONSUMPTION
COST OF THE WAR BY MAJOR MISSIONS AND ACTIVITIES**
(Based on Current Resource Consumption Prior to Any Withdrawals)
(\$ Billions)

	<u>Inter- diction</u>	<u>Offensive Activities^{a/}</u>	<u>Military Security & Defensive Activities^{a/}</u>	<u>Pacifi- cation^{a/}</u>	<u>National Develop- ment</u>	<u>Total</u>
<u>Military Activities</u>						
<u>Land Opns:</u>						
US Forces	0.2	7.1	0.7	0.6	0.1	8.7
Allied Forces		1.7	0.3	0.8		2.8
Total	0.2	8.8	1.0	1.4	0.1	11.5
<u>Air Opns:</u>						
Air Force	3.7	0.2				3.9
Navy/Marines	0.4	0.5	0.1			1.0
Total	4.1	0.7	0.1			4.9
<u>Offshore Opns:</u>	0.4	0.5				0.9
Subtotal	4.7	10.0	1.1	1.4	0.1	17.3
<u>Other:</u>						0.3
TOTAL	4.7	10.0	1.1	1.4	0.1	17.6

^{a/} Allocation to these missions is based primarily on battalion days of operation during the last three months.

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TABLE 6

FY 70 ESTIMATED INCREMENTAL BUDGET
COST OF THE WAR BY MAJOR MISSIONS AND ACTIVITIES
(Based on Nixon Budget Prior to Any Withdrawals) b/
(\$ Billions)

	<u>Inter- diction</u>	<u>Offensive Activities^{a/}</u>	<u>Military Security & Defensive Activities^{a/}</u>	<u>Pacifi- cation^{a/}</u>	<u>National Develop- ment</u>	<u>Total</u>
<u>Military Activities</u>						
<u>Land Opns:</u>						
US Forces	0.2	6.1	0.6	0.5	0.1	7.5
Allied Forces		1.7	0.3	0.8		2.8
Total	0.2	7.8	0.9	1.3	0.1	10.3
<u>Air Opns:</u>						
Air Force	3.4	0.2				3.6
Navy/Marines	0.3	0.4	0.1			0.8
Total	3.7	0.6	0.1			4.4
<u>Offshore Opns:</u>	0.3	0.3				0.6
Subtotal	4.2	8.7	1.0	1.3	0.1	15.3
<u>Other:</u>						0.3
TOTAL	4.2	8.7	1.0	1.3	0.1	15.6

a/ Allocation to these major missions is based primarily on battalion days of operation during the last three months.

b/ Project 703 will reduce the total shown in this table by about \$1.7 billion in FY 70.

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TABLE 7

INCREMENTAL COST OF THE WAR INCLUDED IN CURRENT
FY 70 DEFENSE PROGRAM BY MAJOR MISSIONS AND ACTIVITIES
 (After Impact of Project 703)
 (\$ Billions)

	<u>Inter- diction</u>	<u>Offensive Activities^{a/}</u>	<u>Military Security & Defensive Activities^{a/}</u>	<u>Pacifi- cation^{a/}</u>	<u>National Develop- ment</u>	<u>Total</u>
<u>Military Activities</u>						
<u>Land Opns:</u>						
US Forces	0.1	4.3	0.4	0.4	0.1	5.3
Allied Forces		1.7	0.3	0.8		2.8
Total	0.1	6.0	0.7	1.2	0.1	8.1
<u>Air Opns:</u>						
Air Force	3.0	0.2				3.2
Navy/Marines	0.2	0.4	0.1			0.7
Total	3.2	0.6	0.1			3.9
<u>Offshore Opns:</u>	0.2	0.3				0.5
Subtotal	3.5	6.9	0.8	1.2	0.1	12.5
<u>Other:</u>						0.3
TOTAL	3.5	6.9	0.8	1.2	0.1	12.8

^{a/} Allocation to these major missions is based primarily on battalion days of operation during the last three months.

CONFIDENTIAL

Nov 10

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WHERE THE MONEY GOES

Program Budget for the Vietnam War--FY 69

A detailed program budget for the Vietnam war is now available for the first time, as the result of a nine-month analytical effort. This paper presents the first results which are limited to total US and GVN military expenditures for FY 69. Future papers will cover FY 70-71, as soon as those program budgets are ready, and will include AID, GVN, and third country costs.

Total Cost. The total cost of US and RVNAF operations and investment in South Vietnam during FY 69 was \$20.0 billion.

- US forces cost \$17.4 billion (87%), while RVNAF cost \$2.6 billion (13%).

- Since the US funded most of RVNAF, the total cost to the US (direct plus indirect) was \$19.4 billion, or 97% of the total.

Major Activities. The emphasis in FY 69 was on main force operations and interdiction.

- Main force operations cost \$8.7 billion, or 46% of the \$18.7 billion spent on current operations.

- Interdiction operations by air and land forces cost \$6.4 billion, or 34% of the total; over half (\$3.5 billion) went to air interdiction out-of-country.

- Only \$.3 billion (less than 2%) was used for full time territorial security forces. If the time ARVN and US forces reportedly spent helping the RF/PF is included, the total spent on pacification was \$1.3 billion (7%).

Forces. Air forces consumed almost half of the total cost of operations.

- Air forces (all services) cost \$9.0 billion, or 48% of the total. Most of the air costs were for interdiction (\$5.2 billion); in addition, air forces contributed heavily to main force operations (\$3.3 billion), almost as much as land forces (\$3.8 billion).

- Land forces cost \$6.0 billion (32% of the total), mostly (\$4.9 billion) for main force operations, and ground operations along South Vietnam's borders (interdiction). Most of the rest (\$.9 billion) assisted RF/PF in the territorial security mission.

- General support, consisting of logistics, administration, communications, etc., cost \$3.0 billion, or 16% of the total.

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PROGRAM BUDGET CONCEPTS

Background. Previous articles^{1/} discussed the cost of the Vietnam war in terms of its incremental impact on the Defense budget, and allocated costs to functional activities. The analysis was limited, however, because little detailed information was available in a systematic, internally consistent program budget framework.

During the past nine months, government agencies directly involved with the war collected detailed cost data for FY 68-71 in a comprehensive program budget framework. Information was obtained in South Vietnam and from overseas bases to provide detail, and to verify the timing and exact use of resources consumed by operating units. Interviews with operations officers (G-3) at Corps and Division level, as well as MACV operational data available in computerized form in Saigon and Washington, provided the basis for allocating combat unit costs to various functional activities.

This article is based on US and GVN defense data for the first year for which the analysis has been completed -- FY 69. Future articles will cover FY 70-71, and include resources from other US agencies (AID, USIA, State, etc.), the GVN civil budget, and third countries.

Comments are welcome, and a few copies of the complete program budget matrix (124 resource columns, 433 activity rows) are available upon request.

Cost Concepts. The program budget represents the full cost of resources expended in Vietnam by US, GVN and third countries (in US dollar equivalents at official exchange rates), and out-of-country operations and programs directly related to Vietnam.

The total costs in the program budget are less than other estimates because it excludes CONUS based support costs. (The major exclusions are the cost of CONUS training of US forces, the costs of transporting equipment and supplies to Vietnam, and the cost of maintaining the rotational manpower base.) Also, since some resources may be budgeted for the war in a given fiscal year but actually expended elsewhere or in another period, the program budget is not directly compatible with defense budget figures.

During the formulation of the program budget, the following assumptions were made:

- Time frames: Fiscal years for US and third countries were assumed to occur concurrently with GVN fiscal years, which are actually calendar years. The six-month lag between the US fiscal and the GVN calendar year approximately corresponds to the lag between US obligations and/or expenditures and their impact in RVN.

^{1/} "Cost of the War in Vietnam," SEA Analysis Report, September 1969, pp. 41-47.
"The Cost of the Vietnam War," SEA Analysis Report, August 1968, pp. 41-42.

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- Investment vs. operating costs: Investment (including research; construction; and procurement of equipment minus consumption/attrition) was reported separately from operating costs (O&M, expendable supplies and personnel costs). Combat losses of ships, aircraft, vehicles, and other major equipment were treated as operating costs, as were munitions consumption, replacement parts/spares, etc. Transfers were treated as negative investment for US activities and positive investment for RVNAF activities (funded by the US and MASF).

- Full vs. incremental costs: The program budget uses a "full cost" approach. That is, the full costs of units and activities are included even though some of these costs would be expended elsewhere in peacetime (e.g., the cost of US division units in the baseline forces). Therefore, the program budget does not measure incremental costs (potential peacetime savings).

- Overhead: As far as possible, overhead expenditures were allocated to the output category (or categories) to which they contributed, by factoring if necessary. Unallocable costs (general support categories) were kept to a minimum.

- What was included: Examples of items being included in the program budget are:

- All operations by US, GVN and other FWMAF in RVN.
- All US and GVN military operations in Cambodia and South Laos, plus US air operations in North Laos.
- All allied operations in the NVN panhandle, and elsewhere in NVN when directly related to activity in RVN.
- All 7th Fleet operations directly related to Vietnam.
- All air operations over RVN, NVN, Cambodia, Thailand and Laos by resources based in RVN, Thailand, Guam, Okinawa or the Philippines.
- Medical facilities in Japan and Okinawa used for Vietnam casualties.
- No medical facilities in CONUS.
- No training for US personnel conducted outside Southeast Asia.
- All training of Vietnamese personnel anywhere.
- All activities of the 2nd Logistics Command directly supporting operations in RVN.
- All Voice of America broadcasts in Vietnamese.
- All propaganda pamphlets published in Vietnamese.
- Expenses of other facilities and elements in West Pac not immediately related to Vietnam were prorated to estimate Vietnam-related costs.

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FY 69 RESULTS

The following sections and tables present the FY 69 program budget for all US and RVN military activities relating directly to the Vietnam war.

Total Cost. The total cost of US and RVNAF operations and investment in FY 69 was \$20.0 billion (Table 1). US forces cost \$17.4 billion (87%), while RVNAF cost \$2.6 billion (13%). Since the US funded most of RVNAF directly or indirectly, the total cost to the US was \$19.4 billion, or 97% of the total.

TABLE 1

COST OF MILITARY OPERATIONS AND INVESTMENT IN VIETNAM a/
FY 69
 (US Dollars in Billions)

	<u>Operations</u>	<u>Investment</u>	<u>Total</u>	<u>Percent</u>
US Military Operations	16.2	1.2 b/	17.4	87
RVNAF Operations:				
US Funded	1.9	.1	2.0	10
GVN Funded	.6	*	.6	3
Subtotal	2.5	.1	2.6	13
Total	18.7	1.3	20.0	100

* Less than \$50 million.

a/ Excludes Third Country activities, and GVN activities other than RVNAF (such as RD cadre and National Police) even though they may have military implications.

b/ Includes: .5 billion - net investment in aircraft, ships
 .3 billion - bases/logistics facilities
 .2 billion - research (USAF)
 .2 billion - ports/airfields/LOC, and other.

Most of the costs (\$18.7 billion) were for current operations. Investment costs in FY 69 were relatively low (\$1.3 billion), mainly because most US investment occurred in the buildup years (FY 65-68). The following sections discuss the operations costs (\$18.7 billion) in more detail.

Major Activities. Resources in the FY 69 program budget had their greatest impact during CY 69, a year of high US involvement, and a year of transition from emphasis on the main force war to emphasis on pacification and Vietnamization. The peak of US involvement in Vietnam occurred in mid-1969 with the high point in US military strength occurring in April 1969. Major emphasis in the first half of 1969 was still being placed on containing VC/NVA main forces. The vietnamization program began in July 1969, and a major step in expanding the populated areas under GVN control began with the Accelerated Pacification Campaign in the fall.

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The program budget (Table 2) shows that in terms of costs, the main emphasis in FY 69 was on main force operations and interdiction:

- Main force operations against VC/NVA forces in RVN cost \$8.7 billion, or 46% of the \$18.7 billion spent on current operations.

- Interdiction operations cost \$6.4 billion, or 34% of the total, of which over half (\$3.5 billion) went to out-of-country interdiction of NVA troops and supplies. In-country interdiction (\$2.9 billion) consisted of main force ground operations near the RVN border, CIDG and Special Forces, and harassing and interdicting (H&I) artillery fire.

- Only \$.3 billion (less than 2%) was used for full time territorial security forces (RF/PF). If the time ARVN and US forces spent helping the RF/PF is included, the total spent on territorial security and pacification was \$1.3 billion (7%).

TABLE 2

FORCES AND ACTIVITIES FY 69

(US/RVNAF Operations Cost in \$ Billions)

Forces	Interdiction		Main		Other	Total	(Percent)
	In-Country	Out-of-Country	Force Opns	Territorial Security			
Regular Land Forces	1.1	*	3.8	.3	.2	6.0	(32)
Territorial Forces	--	--	--	.3	*	.3	(2)
Naval Forces	.1	*	.2	*	*	.4	(2)
Air Forces	1.7	3.5	3.3	.	.4	9.0	(48)
General Support	--	--	1.4	--	1.6	3.0	(16)
Total (Percent)	2.9(15)	3.5(19)	8.7(46)	1.3(7)	2.3(13)	18.7	(100)

* Less than .05.

Forces. The program budget shows that air forces consumed almost half of the total cost of operations (Table 2).

- Air forces (all services) cost \$9.0 billion, or 48% of the total \$18.7 billion, to provide fire support, mobility, reconnaissance and intelligence, etc., in support of current operations. Most of the air costs were for interdiction (\$5.2 billion); in addition, air forces contributed heavily to main force operations (\$3.3 billion), almost as much as land forces (\$3.8 billion).

- Land forces cost \$6.0 billion (32% of the total), mostly for main force operations (\$3.8 billion), and ground interdiction operations, including H&I fire (\$1.1 billion). Most of the rest (\$.9 billion) assisted RF/PF in the territorial security mission.

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- Territorial forces (\$3.3 billion) and naval forces (\$.4 billion) made up the rest of the combat costs.

- General support, consisting of logistics, administration, non-combat communications, etc., cost \$3.0 billion, or 16% of the total.

Data by Service. Tables 3, 4, and 5 provide detailed backup data to support the summaries in Tables 2 and 3. We confined our analysis to the major points each table seems to indicate.

- Table 3 shows that if RVNAF maintains its FY 69 mix of activities as US forces draw down, the net result will be a major shift from interdiction and main force operations to pacification. In FY 69 RVNAF spent only 13% of its effort on interdiction, 30% on main force operations and 38% on pacification, as opposed to the US distribution of 38% on interdiction, 49% on main force operations, and 2% on pacification.

- Table 3 also shows that expensive artillery and air support for US ground units caused the combat support "tail" ¹ to be higher for US units (2.9 to 1) than for RVNAF (.7 to 1) on main force operations. General support costs were about the same proportionately (7-8%) for US and RVNAF.

- Table 4 (and backup data) shows that in terms of costs, US ground forces received 1.5 times as much air support relative to main force operations as did ARVN/VNMC: for each dollar spent on land forces, the US spent \$.92 on air support for its own forces, while RVNAF spent \$.08 on VNAF air support and received \$.52 of US air support. ²

- Table 5 shows that of the \$5.3 billion spent on land forces, \$3.9 billion went to combat units and their organic support elements, and \$1.9 billion went to non-organic artillery support. Non-organic artillery thus consumed 11% of the total cost of the war.

- Table 5 also shows that relative to combat units, US forces spent 11 times as much on mobility/transportation and 4 times as much on logistics as did RVNAF: for every dollar spent on combat units, US forces spent \$.64 on mobility and \$.31 on logistics, while RVNAF spent \$.05 and \$.07 respectively.

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TABLE 3

OPERATIONS COSTS OF MAJOR MILITARY ACTIVITIES
FY 69

<u>Security</u>	<u>US Forces</u>		<u>RVN Armed Forces</u>		<u>Total</u>	
	<u>\$ Mil</u>	<u>Percent</u>	<u>\$ Mil</u>	<u>Percent</u>	<u>\$ Mil</u>	<u>Percent</u>
Interdiction						
Out-of-Country	3539	22	11	*	3550	19
In-Country	2527	16	331	13	2858	15
Subtotal	<u>6066</u>	<u>38</u>	<u>342</u>	<u>13</u>	<u>6408</u>	<u>34</u>
Main Force Operations						
Combat	2051	13	441	18	2492	13
Combat Support	4126	25	166	7	4292	23
Combat Service Support	1745	11	126	5	1871	10
Subtotal	<u>7922</u>	<u>49</u>	<u>733</u>	<u>30</u>	<u>8655</u>	<u>46</u>
Territorial Security & Pacification	381	2	943	38	1324	7
Military Protection	259	2	73	3	332	2
Air Defense	13	*	*	*	48	*
Political Operations	51	*	18	1	69	*
General Support	1150	7	190	8	1340	7
Medical	243	2	47	2	290	2
Training	<u>57</u>	<u>*</u>	<u>134</u>	<u>5</u>	<u>191</u>	<u>1</u>
Subtotal Security	16177	100	2481	100	18658	100
<u>Internal Development</u>	6	*	1	*	7	*
<u>Unilateral US Activities</u>	<u>1</u>	<u>*</u>	<u>-</u>	<u>-</u>	<u>1</u>	<u>*</u>
<u>Total</u>	16184	100	2481	100	18665	100

* Less than .5

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TABLE 4

FORCES VS ACTIVITIES

FY 69

(US/RVNAF Operations Costs in \$ Millions)

	Interdiction				Main Force Operations		Territorial Security		Other		Total		
	In-Country		Out-of-Country								US	RVNAF	Total
	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	Total				
Land Forces													
Army	902	239	2	9	2524	548	143	606	174	67	3805	1469	5274
Marines	3	-	-	-	610	6	108	-	-	-	721	6	727
Territorial	-	-	-	-	-	-	-	305	-	24	-	329	329
Total	905	239	2	9	3134	554	251	911	174	91	4526	1804	6330
Navy	55	3	46	-	209	10	11	22	32	-	353	35	388
Air Forces													
Army	153	-	-	-	1856	-	116	-	66	-	2191	-	2191
Air Force	1332	89	2363	2	720	43	3	-	265	19	4683	153	4836
Navy	28	-	990	-	33	-	-	-	-	-	1051	-	1051
Marines	54	-	138	-	657	-	-	-	39	-	888	-	888
Total	1567	89	3491	2	3266	43	119	-	370	19	8813	153	8966
General Support													
Army					1068	111	-	-	686	291	1754	402	2156
Air Force					-	-	-	-	216	36	216	36	252
Navy					1	14	-	-	318	13	319	27	346
Marines					184	1	-	-	19	*	203	1	204
Territorial					-	-	-	10	-	13	-	23	23
Total					1253	126	-	10	1239	353	2492	489	2981
Total													
Army	1055	239	2	9	5502	659	259	606	926	358	7750	1871	9621
Air Force	1332	89	2363	2	720	43	3	-	481	55	4899	189	5088
Navy	83	3	1036	-	243	24	11	22	350	13	1723	62	1785
Marines	57	-	138	-	1451	7	108	-	58	*	1812	7	1819
Territorial	-	-	-	-	-	-	-	315	-	37	-	352	352
Total	2527	331	3539	11	7922	733	381	943	1815	463	16184	2481	18665

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TABLE 5

SERVICES AND FORCES
FY 69
(US/RVNAF Operations Costs in \$ Millions)

	USA	USAF	USN	USMC	Total US
<u>Land/Naval Forces</u>					
Combat Units	2328		86	337	2751
Artillery/Naval Gunfire	1211		193	345	1749
Recon & Intelligence	-		40	-	40
Combat Engineering	160		-	15	175
Communications	48		-	-	48
Psyops	27		-	-	27
Base Support	31		-	-	31
General Combat Support	-		6	24	30
Advisors	-		1	-	1
Transportation/Mobility	-		27	-	27
Total	3805		353	721	4879
<u>Air Forces</u>					
Combat/Fire Support	721	3299	919	653	5592
Mobility	979	423	-	165	1567
Recon & Intelligence	491	625	126	51	1293
Base Support	-	260	-	17	277
Rescue	-	42	6	2	50
Psyops	-	23	-	-	23
Ground Radar	-	8	-	-	8
Herbicide Operations	-	3	-	-	3
Total	2191	4683	1051	888	8813
<u>General Support</u>					
Logistics	732	-	46	64	842
Communications	283	-	11	16	310
Administration	243	30	53	10	336
Recon & Intelligence	172	97	9	-	278
Transportation/Mobility	154	1	-	17	172
Military Police/Courts	47	-	-	11	58
Medical Care	112	31	49	9	201
Formal Training	6	52	-	-	58
Engineering	-	-	48	35	83
Port/Airfield Opns	1	2	55	-	58
Psyops	4	3	5	-	12
Civic Action	-	-	6	-	6
General Support	-	-	37	41	78
Advisors	-	-	-	-	-
Total	1754	216	319	203	2492
<u>Total</u>	7750	4899	1723	1812	16184

* Less than .5

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TABLE 5 (Cont'd)

SERVICES AND FORCES

FF 50

(US/RVNAF Operations Costs in Millions)

	ARVN	VNAF	VNMC	VNMC	PF	PF	Total RVNAF	Total US & RVNAF	%
<u>Land/Naval Forces</u>									
Combat Units	892		24	5	232	94	1248	3999	21.4
Artillery/Naval Gunfire	325		-	-	-	-	325	2074	11.1
Recon & Intelligence	79		-	-	-	-	79	119	.6
Combat Engineering	32		-	*	1	*	33	208	1.1
Communications	4		-	*	-	-	4	52	.3
Psyops	16		-	-	1	*	17	44	.2
Base Support	-		7	-	-	-	7	38	.2
General Combat Support	7		1	-	-	-	8	38	.2
Advisors	114		3	1	-	-	118	119	.7
Transportation/Mobility	-		-	-	-	-	-	27	.2
Total	1469		35	6	235	94	1839	6718	36.0
<u>Air Forces</u>									
Combat/Fire Support		97					97	5689	30.5
Mobility		38					38	1605	8.6
Recon & Intelligence		11					11	1304	7.0
Base Support		6					6	293	1.5
Rescue		-					-	50	.3
Psyops		1					1	24	.1
Ground Radar		*					*	8	*
Herbicide Operations		-					-	3	*
Total		153					153	8966	48.0
<u>General Support</u>									
Logistics	76	-	3	-	5	2	91	933	5.0
Communications	14	-	-	-	*	*	14	324	1.7
Administration	59	-	1	-	1	1	66	402	2.2
Recon & Intelligence	9	-	-	-	-	1	10	288	1.5
Transportation/Mobility	24	1	7	*	*	*	32	204	1.1
Military Police/Courts	13	-	-	-	*	*	13	71	.4
Medical Care	44	1	-	*	1	*	46	247	1.3
Formal Training	88	30	-	*	9	3	134	192	1.0
Engineering	38	-	-	-	*	-	38	121	.7
Port/Airfield Opns	-	-	7	-	-	-	7	65	.4
Psyops	-	*	-	-	-	-	*	12	.1
Civic Action	-	-	-	-	-	-	-	6	*
General Support	31	-	-	1	-	-	32	110	.6
Advisors	5	-	-	-	-	-	6	6	*
Total	402	36	27	1	16	7	489	2981	16.0
<u>Total</u>	1871	189	62	7	251	101	2481	18665	100.0

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Aug-Oct 1971

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WHERE THE MONEY WENT

Program Budget for the Vietnam War - FY 69-71

Summary

A detailed program budget for the Vietnam war for FY 69-71 has been completed. Results for FY 69 were presented in the November-December 1970 Analysis Report. This paper includes the other two fiscal years which have been completed (FY 70-71), and covers the AID, GVN, and third country costs as well.

Total Cost. Reductions in US military activities as part of the Vietnamization caused the annual cost of activities in Vietnam^{1/} to drop \$5.1 billion, or 24% from FY 69 (\$21.5 billion) to FY 71 (\$16.4 billion).

- US military activities declined \$6.3 billion.
- RVNAF activities increased \$1.2 billion, and now account for 25% of US/GVN/FW military costs (\$3.8 billion out of \$15.6 billion).
- Civil activities (\$.8 billion) and third country military activities (\$.5 billion) remained generally constant.

Mix of Forces. By reducing US activities and increasing RVNAF activities, Vietnamization shifted emphasis from air activities to territorial and land forces.

- US and VNAF air activities declined from 47% of total costs in FY 69 to 37% in FY 71.
- Territorial forces increased from \$.4 billion to \$.7 billion, and together with ARVN and remaining US land forces (\$5.5 billion) account for over 40% of total costs.

Major Activities. Despite the declining level of the war, and the changing mix of forces, the funding emphasis in FY 71 was still on main force operations (40%) and interdiction (29%) instead of pacification (10%) and internal development (5%).

1/ Including out-of-country interdiction programs.

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Details

Background. During 1970 government agencies directly involved with the war in Vietnam collected detailed cost data for FY 68 - 71 in a comprehensive program budget framework. The concepts and scope of the budget were explained in a previous article.^{1/}

The program budget has some limitations. First, it is not directly comparable to official DOD estimates of the cost of the war, and should be used only to show resource allocations. Second, the project to collect cost data was terminated before FY 68 Army, and FY 68 and FY 70 civil cost estimates were completed. (Because FY 68 data was so incomplete, we have not shown it in this article.)

Third, it will be impossible to obtain FY 72 or later figures in the same format without a complete retabulation of the earlier data to clarify definitions and assumptions used. The program budget will probably be a one-time effort, primarily because of the massive collection tasks and analysis needed to produce it.

Total Costs. Reductions in US military activities as part of Vietnamization caused the annual cost of activities in Vietnam to drop \$5.1 billion, or 24% from FY 69 to FY 71. Table 1 shows that military and civil costs in Vietnam were \$21.5 billion in FY 69, but dropped to \$16.4 billion in FY 71.

The decline was mainly due to a \$6.3 billion decline in US military costs from FY 69 (\$17.6 billion) to FY 71 (\$11.3 billion). RVNAF activities increased by nearly 50%--\$1.2 billion--to help fill the gap left by departing US forces, and reached \$3.8 billion in FY 71. The combination of US declines and RVNAF increases brought the RVNAF share of US/GVN/FW military costs up to 24% in FY 71, compared to 13% in FY 69.

Civil activities by the US and GVN, and third country military activities remained generally constant during the same period. US AID, State, USIA, Coast Guard, and intelligence operations declined slightly from \$409 million in FY 69 to \$344 million in FY 71, but GVN civil expenditures increased by about the same amount to fill the gap--from \$432 million to \$496 million. Third country costs remained level at \$460-480 million.

Table 1 also shows the funding costs to the US, GVN, and third countries. Since the US funded most of RVNAF and third country forces, the total cost to the US (direct plus indirect) was about 90-95% of the total cost of the war. In FY 69, the war cost the US \$20.4 billion (95% of the total); in

^{1/} November-December 1970 SEA Analysis Report.

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FY 71 the figure dropped to \$14.7 billion (90% of the total).^{1/} GVN expenditures rose more than 50% during the same period.

TABLE 1
COST OF VIETNAM ACTIVITIES - FY69-71
(In Billions of US Dollars)

	<u>FY69</u>	<u>FY70</u>	<u>FY71</u>	<u>% Change FY69-71 a/</u>
<u>Military Operations/Investment</u>				
US	17.6	14.8	11.3	-36
RVNAF	2.6	3.1	3.8	+46
Third Country	.5	NA	.5	0
Total	<u>20.7</u>		<u>15.6</u>	<u>-25</u>
<u>Civil Operations/Investment</u>				
US	.4	NA	.3	-16
GVN	.4	NA	.5	+15
Total	<u>.8</u>		<u>.8</u>	<u>0</u>
<u>Grand Total</u>	<u>21.5</u>		<u>16.4</u>	<u>-24</u>
Cost to US	20.4		14.7	-28
Cost to GVN	1.0		1.6	+52
Cost to Third Countries	.1		.1	+ 4
Total	<u>21.5</u>		<u>16.4</u>	<u>-24</u>

NA = not available.

a/ Percentages based on unrounded dollar amounts.

Mix of Forces. By reducing US activities, which are heavily air-oriented, and increasing RVNAF activities, which are mostly land and territorial forces, Vietnamization caused a major shift in the internal composition of US/GVN forces during FY 69-71. Table 2 shows US/GVN military costs by type of force; all US helicopter operations are included as "Air Forces," and all US logistics and administrative activities are included as "General Support."^{2/}

^{1/} Note that these figures do not agree with official OSD Comptroller estimates of the cost of the war to the Department of Defense, which were \$20.2 billion in FY 68, \$17.6 billion in FY 69, \$12.6 billion in FY 70, and \$8.1 billion in FY 71. As explained in the November/December article, the differences arise from the definition of items included in "SEA-related" and from the timing of expenditures, as well as the exclusion of US civil agency expenditures.

^{2/} Tables 4-6 give a more detailed breakout of each service's figures.

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Air activities declined from 47% of total US/GVN military costs in FY 69 to 37% in FY 71, while the territorial forces portion increased from 2% to 4% (costs up) and land forces increased from 30% to 37% (costs falling slower than air costs). Naval forces and general support declined at the same general rate as overall military costs, so their percentages of the total (2% naval forces, 19-20% general support) remained constant. The same trends will probably continue in FY 72-73 as US forces decline further.

TABLE 2
COST OF US/RVNAF FORCES - FY 69-71

	FY 69		FY 71	
	\$ Billions	%	\$ Billions	%
US Forces				
Land Forces	4.6	23	3.7	25
Naval Forces	.4	2	.1	1
Air Forces	9.3	46	5.3	35
General Support	3.3	16	2.2	14
Total	17.6	87	11.3	75
RVNAF				
Regular Land Forces	1.5	7	1.8	12
Territorial Forces	.4	2	.7	4
Naval Forces	*	*	.1	1
Air Forces	.2	1	.3	2
General Support	.5	3	.9	6
Total	2.6	13	3.8	25
Total US & RVNAF				
Land Forces	6.1	30	5.5	37
Territorial Forces	.4	2	.7	4
Naval Forces	.4	2	.2	2
Air Forces	9.5	47	5.6	37
General Support	3.8	19	3.1	20
Grand Total	20.2	100	15.1	100

* Less than \$.05 billion or .5%.

a/ Percentages based on unrounded dollar amounts.

Major Activities. Despite the declining level of the war and the changing mix of forces, the emphasis in FY 71 was still on main force operations (40%) and interdiction (29%) instead of pacification (10%) and internal development (5%).

1/ Territorial Security and Law Enforcement.

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Table 3 shows the allocation of US/GVN costs to the program budget categories of Security, Internal Development, and Unilateral Activities, and their subcategories. In FY 71 interdiction (\$4.6 billion) and main force operations (\$6.4 billion) were still the most costly US/GVN activities, even though US withdrawals reduced them to 30% below their FY 69 levels.

The relatively inexpensive pacification and internal development activities have always cost only a fraction of regular military activities, but Vietnamization and increased GVN awareness of these activities led to a modest increase during FY 69-71. Territorial security, law enforcement, and internal development grew from \$2.1 billion in FY 69 to \$2.3 billion in FY 71 while most other areas were declining, so their share of US/GVN costs rose from 10% to 15%. (See Table 3)

Detailed Program Budget Data. Tables 4-6 give more detailed breakouts of US/GVN forces and activities by service. They support the general conclusions drawn above, and are presented for the use of those interested in identifying more specifically how each kind of force is funded.

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TABLE 3

MAJOR US/GVN ACTIVITIES IN VIETNAM (Costs in Millions of US Dollars)

	FY 69				FY 71			
	US	GVN	Total	%	US	GVN	Total	%
<u>Security</u>								
Interdiction:								
Out-of-Country	3746	11	3757		2584	102	2686	
In-Country	2642	341	2983		1688	186	1874	
Sub-Total	6388	352	6740	32.0	4272	288	4560	28.6
Main Force Operations:								
Combat	2052	445	2497		1740	586	2326	
Combat Support	4439	174	4613		2233	430	2663	
Combat Service Support	1807	133	1940		896	477	1373	
Sub-Total	8298	752	9050	42.9	4869	1493	6362	39.9
Territorial Security and								
Law Enforcement	407	1089	1496	7.1	294	1287	1581	9.9
Military Protection	259	76	335	1.6	143	101	244	1.5
Air Defense	48	1	49	.2	34	1	35	.2
Political Operations	52	16	70	.3	23	97	120	.8
General Support	1744	200	1944	9.2	1380	236	1616	10.1
Medical	262	47	309	1.5	129	58	187	1.2
Formal Training	58	135	193	.9	173	201	374	2.4
Sub-Total Security	17516	2670	20186	95.7	11317	3762	15079	94.6
<u>Internal Development</u>								
Agriculture/Nat. Resources	22	9	31		15	7	22	
Industry/Commerce	0	11	11		1	161	162	
Transportation	74	24	98		66	11	77	
Power/Communications	16	3	19		14	14	28	
Education	12	69	81		11	93	104	
Labor	1	1	2		1	4	5	
Health	40	30	70		33	44	77	
Housing/Welfare	6	4	10		14	0	14	
Refugees	54	17	71		41	0	41	
Veterans	0	20	20		3	0	3	
National Government	14	28	42		7	18	25	
Provincial/Local Gov't	24	37	61		15	0	15	
Program Admin./Other	5	94	99		3	144	147	
Sub-Total Development	268	347	615	3.0	224	496	720	4.6
<u>Unilateral US Activities</u>								
Intelligence	21	0	21		2	0	2	
Research	175	0	175		55	0	55	
Admin./Other	74	0	74		80	0	80	
Sub-Total US Activities	270	0	270	1.3	137	0	137	.8
Grand Total	18054	3017	21071	100.0	11678	4258	15936	100.0

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TABLE 4

FORCES VS. ACTIVITIES - FY 69
(Cost in Millions of US Dollars)

	Interdiction				Main Force Operations		Territorial Security		Other		Total		
	In-Country US	RVNAF	Out-of-Country US	RVNAF							US	RVNAF	Total
Land Forces													
Army	990	239	2	9	2584	548	143	606	174	67	3893	1469	5362
Marines	3	-	-	-	611	8	107	-	-	-	721	8	729
Territorial	-	-	-	-	-	-	-	346	-	-	-	372	372
Total	993	239	2	9	3195	556	250	952	174	93	4614	1849	6463
Naval Forces	56	4	47	-	217	12	11	29	32	-	363	45	408
Air Forces													
Army	153	-	50	-	1856	-	116	-	102	-	2277	-	2277
Air Force	1341	98	2401	3	736	51	3	-	266	23	4747	175	4922
Navy	29	-	1102	-	34	-	-	-	-	-	1165	-	1165
Marines	56	-	144	-	942	-	-	-	-	-	1181	-	1181
Total	1579	98	3597	3	3568	51	119	-	407	23	9370	175	9545
General Support													
Army	-	-	-	-	1130	112	-	-	916	291	2046	403	2449
Air Force	-	-	-	-	-	-	-	-	516	40	516	40	556
Navy	-	-	-	-	1	20	-	-	532	13	533	33	566
Marines	-	-	-	-	184	1	-	-	19	1	203	2	205
Territorial	-	-	-	-	-	-	-	22	-	16	-	38	38
Total	-	-	-	-	1315	133	-	22	1983	361	3298	516	3814
Total	2628	341	3746	12	8295	752	380	1003	2596	477	17645	2585	20230

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TABLE 5
FORCES VS. ACTIVITIES - FY 70
(Cost in Millions of US Dollars)

	Interdiction In Country		Out-of- Country		Main Force Operations		Territorial Security		Other		Total		
	US RVNAF		US RVNAF		US RVNAF		US RVNAF		US RVNAF		US RVNAF Total		
	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	Total
Land Forces													
Army	996	31	11	-	2693	736	174	426	170	55	4044	1248	5292
Marines	5	-	-	-	399	12	61	1	-	-	465	13	478
Territorial	-	-	-	-	-	-	-	435	-	99	-	534	534
Total	1001	31	11	-	3092	748	235	862	170	154	4509	1795	6304
Naval Forces	56	21	14	-	105	49	15	70	55	-	255	140	395
Air Forces													
Army	225	-	176	-	1187	-	73	-	155	-	1816	-	1816
Air Force	1031	101	1954	13	594	87	1	-	234	45	3814	246	4060
Navy	20	-	772	-	38	-	-	-	-	-	829	-	829
Marines	135	-	126	-	498	-	-	-	36	-	795	-	795
Total	1411	101	3027	13	2317	87	74	-	425	45	7254	246	7500
General Support													
Army	-	-	-	-	1159	611	-	-	696	79	1855	690	2545
Air Force	-	-	-	-	-	-	-	-	434	91	434	91	525
Navy	-	-	-	-	3	53	-	-	324	26	327	79	406
Marines	-	-	-	-	157	4	-	-	34	2	191	6	197
Territorial	-	-	-	-	-	-	-	22	-	21	-	43	43
Total	-	-	-	-	1319	668	-	22	1488	219	2807	909	3716
Total	2478	153	3052	13	6633	1552	324	954	2138	418	14825	3090	17915

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TABLE 6

FORCES VS. ACTIVITIES - FY 71
(Cost in Millions of US Dollars)

	Interdiction In-Country		Out-of Country		Main Force Operations		Territorial Security		Other		Total		
	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	US	RVNAF	Total
Land Forces													
Army	847	146	10	48	2402	621	179	681	77	76	3515	1772	5287
Marines	2	-	-	-	186	13	31	-	-	-	219	13	232
Territorial	-	-	-	-	-	-	-	-	-	-	-	-	-
Total	849	146	10	48	2588	634	210	681	77	76	3734	1785	5519
Naval Forces													
	37	20	12	1	38	33	5	73	21	-	113	127	240
Air Forces													
Army	160	-	128	-	876	-	52	-	113	-	1329	-	1329
Air Force	549	80	1707	53	502	149	-	-	184	68	2942	310	3252
Navy	21	-	669	-	42	-	-	-	-	-	732	-	732
Marines	63	-	57	-	157	-	-	-	-	-	289	-	289
Total	793	80	2561	53	1577	149	52	-	369	68	5292	310	5602
General Support													
Army	-	-	-	-	567	416	-	-	942	248	1509	664	2173
Air Force	-	-	-	-	-	-	-	-	384	92	384	92	476
Navy	-	-	-	-	-	-	-	-	189	49	196	107	303
Marines	-	-	-	-	7	58	-	-	-	-	106	3	109
Territorial	-	-	-	-	90	2	-	-	16	1	-	25	25
Total	-	-	-	-	664	476	-	-	1531	391	2195	891	3086
Total	1679	186	2583	102	4867	1492	267	1287	1938	695	11334	3752	15086

* Less than \$.5 million.

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Feb 67

ECONOMIC IMPACT - KOREA AND SOUTH VIETNAM BUILDUPS

The conflict and the rapid buildup of U.S. force resulted in serious inflationary pressures in Korea during the Korean War; pressures more serious than these being experienced in South Vietnam. Increased government spending for national defense coupled with spending of allied forces caused excessive demand for a limited amount of local resources, and as has occurred in Vietnam the amount of goods and services available is reduced by the dislocation and destruction of the war.

In the first year of the Korean conflict retail prices in Pusan rose by more than 7-1/2 times, and before the conflict was over prices were more than 24 times higher than before the war. In Vietnam prices have a little more than doubled since the buildup began in earnest a year and a half ago.

TABLE 1

COMPARATIVE PRICE INCREASES IN KOREA AND IN VIETNAM ^{1/}

	Mid-Year Retail Prices Pusan		Mid-Year Retail Prices Saigon
1946	16.7	1961	77.8
1947	31.3	1962	80.7
1948	52.7	1963	85.2
1949	47.3	1964	86.7
1950	100.0	1965	100.0
1951	767.6	1966	156.3
1952	1894.0	Dec '66	208.9
1953	2488.8		

^{1/} Mid-1950 = 100. and mid-1965 = 100. These dates are taken as the starting points of the two buildups.

However, inflation was a greater problem in Korea even before the conflict began. From 1946 through 1950 Korean prices increased six fold while in the four years before 1965 Vietnamese prices increased by 50 percent. In both countries, however, the pace of inflation increased with the arrival of allied forces.

Money Supply and the Price Index

The relationship between the increase in the price index and the increase in the money supply for the two countries also can be seen in Table 1.

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TABLE 2

INCREASES IN THE MONEY SUPPLY AND INCREASES IN THE PRICE INDEX IN KOREA AND IN VIETNAM

KOREA			SOUTH VIETNAM		
	End-Year Money Supply (Hwan Billions)	End-Year Retail Price Index ¹ -Pusan		End-Year Money Supply (P Billions)	End-Year Retail Price Index ¹ -Saigon
1947	52.9	42.0	1961	17.2	79.3
1948	74.4	64.4	1962	19.5	83.0
1949	134.7	88.2	1963	22.3	86.0
1950	314.9	437.6	1964	27.4	93.4
1951	812.4	1378.9	1965	47.6	128.2
1952	1593.1	2207.6	1966	67.0	208.9
1953	3371.0	2786.0			

¹/ Mid-1950 = 100 and mid-1965 = 100. These dates are taken as the starting points of the two buildups.

An increase in the money supply, all other things equal, will bring a proportionate increase in prices. However, because of loss of confidence, there can be a disproportionate reaction to large and continued increases in the money supply. This happened in Korea and there is danger of it happening in Vietnam. The political and military situation can also affect confidence in the currency.

In Korea the relationship between the increases in money supply and increases in prices passed through three phases. In the first phase (the pre-war years) prices rose at a slower rate than the increase in money supply - from the end of 1947 to the end of 1949 while money supply tripled, prices doubled. In the second phase (the first two years of the war 1950 and 1951) prices rose much faster than the money supply - while money supply rose by a little more than six times prices rose by more than 15 times. Then in the third phase (from the end of 1951 to the end of 1953) prices again rose at a slower rate - while the money supply quadrupled, prices doubled.

In Vietnam prices have risen less than money supply increases in every year, from 1961 through the end of 1965. In 1966, however, prices rose faster - while the money supply increased by slightly less than 50 percent, prices increased by slightly more than that figure.

War almost invariable brings sharp increases in the money supply. Government expenditures increase while revenues, because of war disruption, decline. To finance the deficit the government will generally resort to printing money. Allied forces will also need money for local purchases which again will be printed to supply their needs. Tables III and IV show some of the major factors influencing the changes in the money supply in the two countries.

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Possible Remedial Actions

Controlling inflation must involve measures which reduce the need to print money by either (a) increasing revenues, (b) reducing costs (of the local government and of the allied forces), (c) reducing extensions of credit, or (d) increasing imports (i.e. offsetting increasing demand through increasing imports).

Thus far there has been much greater success in controlling the Vietnam inflation than there was with inflation in Korea.

First, there has been a much larger and more consistent import program in Vietnam. Table IV shows that money absorption from import has more than offset money creation through spending by Allied Forces in every year of the Vietnam buildup. In Korea imports never offset Allied spending and in the first phase of the conflict (2nd Q CY 50 to 1st Q CY 51) imports were pitifully low (largely due to the closing down of ECA and the lag before a substitute was found).

In the second place, there has been much more careful control of spending by Allied Forces in Vietnam. In Korea there were various recommendations to reduce local hire and to increase off-shore purchases, but there was no control mechanism introduced such as the present "plaster ceiling."

Third, credit expansion in Korea was much greater and much more erratic. Until CY 66 credit expansion in Vietnam has been negligible. The increase that year (and for CY 67) was associated with the large increase in imports.

However, in both Korea and Vietnam government budget control and increased revenues have been difficult to achieve. The Korean government was able to balance its budget after March 1951 only by having the UN take over the financing of some of its accounts (e.g. the care of refugees and POWs).

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TABLE 3

CHANGES IN MONEY SUPPLY BY MAJOR CAUSE:^{1/} KOREA (Hwan Billions)

		CY 48 (3rd Quarter)	CY 50 (2nd Quarter)	CY 51 (1st Quarter)	CY 51 (4th Quarter)
	Increases in Money Supply	Base Period	58.9	304.8	385.4
1)	Increases in Government Deficit	Base Period	71.5	182.3	-45.0
2)	Increases in Allied Forces' Spending	Base Period	0	101.2	362.2
3)	Increases in Credit	Base Period	41.4	17.3	188.9
4)	Increases in Imports	Ease Period	57.3	7.8	140.1

^{1/} Rows 1), 2), and 3) are major causes of money creation; Row 4) is a major source of money absorption. But Increases in Money Supply will not equal 1) plus 2) plus 3) minus 4) because minor factors (e. g. invisibles) have not been included.

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TABLE 1
CHANGES IN MONEY SUPPLY BY MAJOR CAUSE: ^{1/}
VIETNAM
(P Billions)

	<u>CY63</u>	<u>CY64</u>	<u>CY65</u>	<u>CY66</u>
Increases in Money Supply	2.8	5.1	20.2	20.0
1) Increases in Government Deficit	3.1	10.3	19.0	21.4
2) Increases in Allied Forces Spending	0	2.0	9.0	33.5
3) Increases in Credit	.5	.1	-.7	4.0
4) Increases in Imports	7.5	8.8	11.2	37.7

^{1/} Rows 1), 2), and 3) are major causes of money creation; row 4) is a major source of money absorption. But Increases in Money Supply will not equal 1) plus 2) plus 3) minus 4) because minor factors (e.g., invisibles) have not been included.

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DOD PIASTER SPENDING IN VIETNAM

The 1966 anti-inflation program in SVN included a severe currency devaluation and introduction of piaster spending limitations by DOD, other US agencies and the GVN. These steps were taken to reduce inflationary spending which had caused the cost of living to rise 79% during the 12 months preceding the devaluation. DOD's spending goal of P42 billion (P21.5 billion in the 1st half year and P20.5 in the second) for CY 67 was established at the time Deployment Plan #4 was developed. The second half goal is to be reviewed in May or June and will be revised if it is insufficient to support Plan #4.

Spending to date is shown below. The CY 67 projections assume a level of spending per man only slightly below the level at the end of CY 66 (but above Jan 67). The first half goal of P21.5 billion seems likely to be met; CINCPAC shares this expectation.

PIASTER SPENDING (P Billion)

	Actual			Projected CY 67	
	CY 66		CY 67		
	3d Qtr	4th Qtr	Jan	1st Half	2d Half
O&M & Personal ^{a/}	P6.9	P7.9	P2.5	P18.2	P19.4
Contract Construction	1.7	1.2	.5	2.8	2.0
	<u>P8.6</u>	<u>P9.1</u>	<u>P3.0</u>	<u>P21.0</u>	<u>P21.4</u>
O&M & Personal Per Man Month	7770	7295	6130	7200 ^{b/}	7200 ^{b/}

^{a/} Including AIK. ^{b/} By assumption.

Increasing average troop strength will prevent achievement of the second half goal of P20.5 billion unless spending per man falls 6-7% further, to P6800. This fall may occur since Christmas shopping may have increased the end CY 66 figures. CINCPAC continues to estimate that P22.8 billion will be required for the second half of CY 67. ^{1/}

Prospects for successfully limiting spending to P42 billion in CY 67 will depend on:

- the effect of projected movement of units to rural areas, increases in PX facilities, and R&R on troop spending.
- further movements of prices and wages. The calculations shown above do not allow for price rises. While the prices MACV pays have risen only 3% since August, retail prices have risen over 30%. Rising retail prices may increase troop spending.
- whether a further round of wage increases can be prevented.
- the ability of troop construction units to hold down their piaster spending as they take over more of the construction program.

^{1/} Actual MACV spending will exceed the goals as presently defined when MACV takes over some functions from AID. Since AID will furnish the piasters from its own budget, this spending will not violate Ambassador Lodge's overall goals for US agencies.

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April 1967

THE PROSPECTIVE CY 67 INFLATIONARY GAP AND INFLATIONARY PRESSURES
IN VIETNAM DURING CY 67

Summary

The Mission's recent CY 67 "inflationary gap" (increase in the money supply) estimates range from P3 to P30 billion with P17 as their "best" estimate. For reasons discussed below, P10 billion seems like a better estimate, however. Table 1 shows CY 67 gaps as a percent of the money supply. Under stable conditions and with time for adjustment, these proportions would also represent expected price level changes. Economic growth tends to reduce the price changes associated with any given gap and expectation of future inflation increases it. As is shown below, the relation in Vietnam has been quite unstable, due largely to changing expectations. For CY 67 gaps in the neighborhood of P10-P15 billion, the expected ratio of price changes to money supply changes is probably at least 1 to 1 and possibly somewhat higher.

TABLE 1

CY 67 MONEY SUPPLY INCREASES

CY 67 Gap	% Change In CY 67 Money Supply ^{a/}
10	15.8%
15	23.7
20	31.5
25	39.4
30	47.3

^{a/} Changes as a percent of the end of CY 66 money supply net of MACV balances.

Actual price and money supply developments during early 1967 suggest that prices may still be rising faster than the money supply (as was true at the end of CY 66). This is so even when special conditions affecting rice are considered. In the first two months of 1967, the money supply increase (the gap) was P15.6 billion at an

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annual rate of 6% at a quarterly rate. ^{1/} Prices, however, rose 20%. The part of this rise which cannot be "explained" by rice prices is about 7% or 28% on an annual basis, a price rise proportionately larger than the monetary growth. This probably means that the public expects significant inflation to continue in CY 67. If this is so, prices will rise faster than money supply in early CY 67 even if a low gap is developing.

Forecasts of CY 67 Gap

Table 2 shows the recent Mission "best" inflationary gap estimate, the estimate on which Ambassador Lodge based the CY 67 stabilization program and, for comparison, the estimated CY 66 gap. The Embassy regards a gap of P17 billion as most likely and says that the "target gap" of P10 billion is not attainable. ^{2/}

The new estimates differ from the earlier ones for CY 67 in several ways. Estimated import payments have fallen slightly due to abnormal inventory accumulation in CY 66. This leads to a decline in forecast customs and austerity revenues, and a reduction in credit as loans to finance inventories are paid off.

Another important difference is the rice and fertilizer subsidy which was either "netted out" of imports, or overlooked, in the September estimates.

The Mission shows US military spending of P44.5 billion, the CINCPAC/MACV stated piaster requirement for CY 67. Earlier OSD estimates suggested that combined "O&M and personal spending" rates of no more than P7200 per US man month would be attainable. The P42 billion target for CY 67 (P21.5 billion for the first half year) was established on this basis. However, favorable experience in January and February suggests that the estimate should be scaled down considerably, not increased. Table 3 shows the spending rates per man month for the last half of CY 66 and the first two months of CY 67. Table 4 projects total spending for CY 67, assuming various rates per man under presently approved deployments. When the very low rates for February are adjusted to allow for Tet, and for the shortness of the month, they fall near or just above the January rates. While another month or two of experience is desirable to confirm these rates as a basis for a low estimate for the year, Tables 3 and 4 suggest that

^{1/} Net of changes in MACV cash balances.

^{2/} This is a correction of the Mission's earlier estimate of P20 billion as most likely.

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TABLE 2

INFLATIONARY GAP ESTIMATES (P Billion)

	<u>CY 66 a/</u>	<u>CY 67 Gap</u>	
		<u>15 Sep 66 Embassy Target</u>	<u>15 Mar 67 Embassy Estimate</u>
Monetary Injection			
GVN Military	P62.2	P50.0	P44.8 b/
GVN Civil		31.0 c/	33.0
US Military		42.0	44.5 b/
US Civil	37.7	10.0 c/	8.0
Non-US Piaster Purchases		1.0	3.3
Exports	2.1	2.0	2.0
Credit Expansion d/	14.7	12.0	1.0
Subsidies	e/	e/	9.0
Total	<u>P116.7</u>	<u>P148.0</u>	<u>P145.6</u>
Monetary Withdrawals			
GVN Imports	20.1		31.8
CIP Imports	22.7	58.9 e/	18.9 72.4
Food for Peace	7.7		13.6
Special Rice Imports	n.a.	n.a.	8.1
Equalization Tax	8.4	n.a.	n.a.
Customs, Austerity and Persecution Revenues	14.4	22.0	19.6
Domestic Revenues	16.0	20.0	26.0
Invisibles	9.4	10.0	10.6
Total	<u>P98.7</u>	<u>P138.0</u>	<u>P128.6</u>
Gap	P18.0	P10.0	P17.0 f/

a/ NBVN estimates adjusted.

b/ P2.5 billion AIK, included by Embassy in GVN Military, shifted here to US Military for consistency.

c/ P6.0 billion formerly included in US Civil Budget (AID financed) shifted to GVN Civil Budget for consistency.

d/ Credit expansion net of time deposits.

e/ For CY 66, the subsidies on fertilizer and rice are shown as reduced import values rather than as an explicit expense. They may have been omitted entirely in the 15 September estimates.

f/ Corrected Mission estimates range from P3-P30 billion; P17 most likely.

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TABLE 3

ACTUAL PIASER SPENDING (P BILLION)

	CY 66		CY 67	
	3d Qtr	4th Qtr	Jan	Feb
O&M & Personal Spending	P6.9	P7.9	P2.5	P2.3
Contract Construction	1.7	1.2	.5	.5
Total	P8.6	P9.1	P3.0	P2.8
O&M & Personal Spending Per US Man Month	P7770	P7295	P6180	P5591

TABLE 4

PROJECTED PIASER SPENDING - CY 67 (P Billion)

<u>O&M & Personal Spending Per US Man Month</u>	<u>Projected Spending^{a/} (P Billion)</u>
P7200	P42.00
6500	39.92
6300	37.28
6100	35.74

^{a/} Construction estimates of P2.2 billion and P1.7 billion respectively have been used for the 1st and 2d halves of CY67. CINCPAC is estimating P2.8 billion for 1st half CY67 construction spending. Program 4 deployments assumed.

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spending much lower than P--.5 billion is very likely. However, the estimated SVN expenditures include P4.0 billion for RVNAF rations and P2.3 billion for a June 1 civil service pay raise. If there is a pay raise for US employees it will, of course, raise MACV spending, but even so, P4.5 billion seems like a high estimate. If MACV spending does hold to the neighborhood of P38-40 billion, the gap, accepting the Mission's other "most likely" assumptions, will be around P12.5 billion. But it seems likely that the subsidy figure is overstated and that credit expansion will be zero or negative. Thus there is still some hope for a gap of close to P10 billion in CY 67.

Money Supply and Price Changes

The relation between changes in the money supply and changes in price indices is a crucial part of the analysis of inflationary prospects for CY 67. Quarterly changes in the money supply and price levels in SVN are shown in Table 5 for the period since US forces and inflation began to have an important impact on the SVN economy. The table shows that, on average, rates of price increase have recently been .79 times the rate of money supply increase in the previous quarter. The average, unlagged, is 1.02. However, the relationships are quite unstable, depending as they do on expectations about future inflation; the observations are too few to reveal much in any case. Analysis of monthly data, employing various lags, leads to similar conclusions, as does comparison of the period 1959 to 1964 with this more recent period.

While there is no obvious trend, the last observations in both the lagged and unlagged series are relatively large and for the first quarter of CY 67, the ratio is 1.2 to 1 "allowing for rice". 3/ 4/ Thus for the most recent 5 months, prices have risen somewhat faster than the money supply. This may well continue for some time longer despite US (and GVN) spending control programs. Any estimates of CY 67 price changes based on the inflationary gap calculations are subject to gross uncertainty, but it seems likely that prices will grow somewhat faster than money in the next few months though probably not for the year as a whole if spending controls are effective.

3/ Based on the USAID index, since the NIS is not available for this period.

4/ The next section estimates the impact of rice prices on the index.

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TABLE 5

SWN PRICE INDEX AND MONEY SUPPLY, 1965 -

	End of	% Change In Prices a/	% Change In Money Supply b/	Ratio Price Changes to Money Supply	
				Unlagged	Lagged c/
1965	2d Qtr	8.9%	10.3%	.86	1.44
	3d Qtr	14.8	15.5	.95	.83
	4th Qtr	12.9	12.7	1.02	.86
1966	1st Qtr	10.9	16.7	.65	.71
	2d Qtr	11.8 d/	13.0 d/	.91	-.15
	3d Qtr	-1.9 d/	5.4	-.35	1.04
	4th Qtr		1.8	3.11	
Mean				1.02	.79
S. D.				.96	.48

a/ MIS cost of living index, working class.

b/ Currency plus private demand deposits, adjusted for US troop private spending in 2d Qtr 1965 (\$35 man/month, at "black market" exchange rates) and adjusted for MACV balances beginning December 1965.

c/ Ratio is % change in prices lagged one quarter, divided by % change in money supply unlagged. E.g., $14.8/10.3 = 1.44$ for 2d Qtr 1965.

d/ Adjusted for June 1966 devaluation by extrapolation of price changes which "would have occurred" in June and July without devaluation.

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First Quarter 1967 Price Changes

Recent movements of retail and rice prices are shown in Table 6. Consumer prices rose about 20% during the 1st Quarter of CY 67. Much of the rise was due to the extreme movements of rice prices shown below. These movements in the price of rice which comprises about 17% of the USAID index, "explain" 65% of the increase in the index during early 1967. These rice price movements were related to local and temporary inventory exhaustions and do not reflect changes in the money supply and overall inflationary pressures in SVN. It is thought that they will be largely reversed in the coming months, and the reversal has already begun. If it is accepted that 65% of the 20% price rise is not due to monetary (inflationary) factors, the inflationary pressure in early CY 67 was only slightly in excess of that implied by changes in the money supply. These last were about 6% (March estimated) while the non-rice price rise was about 7%, a ratio of price rise to monetary increase of 1.2 to 1.

TABLE 6
RETAIL PRICES 1966-1967

<u>Date</u>	<u>All Items a/</u>	<u>Soc Nau Rice b/</u>
Dec 27	216	1650
Jan 30	254	2100
Feb 27	255	2300
Mar 6	273	3200
Mar 10		3700
Mar 13	284	3300
Mar 20	261	2900
Mar 22		3000
Mar 27	260	2900
Apr 3	261	2700

a/ USAID retail price index. This is similar to the NIS index used in Table 5, but the NIS index is not available for these recent periods and is only calculated monthly.

b/ Price per 100 kilo. New rice crop marketed on Jan 9.

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SVN INFLATION IN CY 67

CY 67 inflation can be held to 21-25%, recognizing periods of uncertainty (e.g., elections) and short-term shortage (e.g., rice). CY 67 inflation through 30 April has been 15%. A rate of inflation of 25% has the same effect on the incomes of GVN employees and members of the Armed Forces as cutting their salaries by 20%.

The MACV additions to the approved deployment plan would not appreciably affect piaster spending or inflation in CY 67 but would affect spending and possibly inflation in CY 68 and CY 69. Piaster cost per year of 15,000 troops is roughly P1 billion.

The Dangers of Inflation

A modest degree of inflation in Vietnam could be helpful. Pressure from rising prices forces rural and urban families to seek additional income through higher paying jobs and secondary employment. Labor mobility and total output are thereby increased.

Also, several of the usual disadvantages of inflation are not applicable to SVN. For example, inflation usually leads to balance of payments difficulties as domestic and export prices become relatively higher and import prices become relatively lower. But in SVN the US military (who buy their piasters with dollars) supplies foreign exchange and US AID through CIP supplies imports. In SVN, the US commitment thus offsets the balance of payments effect of inflation.

Nonetheless, Vietnamese inflation in CY 66 was not modest: 80% per year or 6% per month. Such large price rises produce several ill effects in SVN.

In the first place, people on fixed incomes (notably civil servants and members of the armed services) are made relatively worse off as the purchasing power of their income drops. The government and the Army lose their best people since other positions become financially more attractive. Second, inflation breeds corruption as people try to supplement their income by other means if, like the military, they cannot change jobs.

Finally, popular support for the GVN is undermined if it is unable to effectively manage the country's economy.

Causes of SVN Inflation

Inflation in SVN is caused by too much demand for a limited amount of local resources. The US, the GVN, the private economy (and to some extent even the VC) are all competing for a small amount of local resources often made yet smaller by war damage.

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The GVN prints money to meet its needs and those of the U.S., since it does not collect enough in taxes. Financing war-generated demands through increasing the money supply instead of through taxation adds new demands to the economy without cutting private demand. Inflation results.

Increases in the money supply will bring a proportionate increase in prices if all else remains equal. The phrase "if all else remains equal" is important. Price increases can be less than the increase in money supply. A growing economy makes more goods available and this reduces the price rise associated with increases in money supply. Similarly, in countries like Vietnam, substitution of a money economy for barter arrangements allows for some increase in money supply without creating price rises.

On the other hand, price rises can exceed increases in the money supply. Disproportionate price increases most often result from a loss of confidence in the currency. This loss of confidence, due to previous inflation or political-military factors, causes people to shift from holding money to holding goods. People are willing to pay higher prices for goods which they expect will cost even more in the near future.

In SVN increases in prices have been less than increases in the money supply until quite recently. (See Table 1). The change occurred in CY 66 when the money supply increased by slightly less than 50% and prices increased by slightly more than that figure.

The CY 66 trend appears to be continuing in CY 67, based on 1st Quarter results. Price rises in SVN currently are exceeding money supply increases by a ratio of 1.2 to 1, even allowing for the recent rice price increases resulting from a short-lived shortage.

The Outlook for CY 67

Prices in SVN will rise 32% in CY 67 based on the P17 billion increase in money supply ("gap") estimated by the US mission and a 1.2 to 1 ratio. (See Tables 2 and 3). However, several factors may change the gap projection. Most significant is a lower estimate of US military piaster spending.

The "Piaster Ceiling." On July 1, 1966, the Secretary of Defense established a quarterly "piaster ceiling" whereby JCS was directed to limit (through CINCPAC and COMUSMACV) military and contractor piaster spending. The ceiling for each of the first two quarters was P9 billion. MACV spent P8.5 billion the first quarter and P9.08 billion the second, a total of only P17.6 billion against a forecast of P23.1 billion if no ceiling had existed. Such savings were the result of more careful buying, increased offshore procurement, greater efficiency in construction and a public campaign to induce troops to spend fewer piasters.

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In November 1966, CINCPAC/MACV estimated their CY piaster needs to be P44.5 billion. OSD at the same time estimated spending to be P41.7 billion for the year. It now appears that both estimates are too high. The CINCPAC/MACV Piaster Expenditure Reduction Program has been more effective more quickly than was anticipated. The latest OSD projection for CY 67 is only P36.4 billion. (Table 4).

Besides military piaster savings, two other factors may reduce the projected CY 67 gap. First, the P9 billion for subsidies (whereby rice and fertilizer are sold at a lower rate than P118 to \$1) may be overstated and may be only P4 billion. Second, credit expansion will probably be zero or negative instead of P1 billion.

All of these changes could reduce the projected gap to P2.9 billion. But some programs may be revised in a way that will increase it. First, COMUSMACV has requested an increase in the strength of the Vietnamese Armed Forces of 50,000 men starting 1 July. If all 50,000 were on board on 1 July (which is unlikely) GVN military spending would increase only P.9 billion in CY 67. Second, salaries of Vietnamese citizens working for the US Government may be raised, increasing expenditures by P2 billion.

Based on the above changes, CY 67 money supply increases would be only P5.8 billion. Using a ratio of increased prices to increases in money supply of 1.2 to 1, the inflation in SVN for CY 67 would be only 14%. (See Table 2.)

A 14% rate of inflation in SVN would be quite acceptable for CY 67 considering the much higher rates that have prevailed recently. However, particular shortages (e.g., the recent rice crisis) can cause the price of certain commodities to rise, and once prices have gone up they never fall back completely to their old levels. Also, several political periods of uneasiness (e.g., elections) this year could influence prices. Thus an inflation of 20 to 25% is likely.

There is still one large unknown factor which may alter the long run projections substantially. COMUSMACV has asked for additional forces by the end of CY 68.

No troop buildup is likely to disrupt the stabilization effort this year. Not many of them will reach SVN in CY 67. Roughly P1 billion will "buy" 15,000 troops per year or 30,000 troops for 6 months, so the CY 67 gap would probably not be increased by more than P1 or P2 billion.

But the long run implications of a large number of troops is more severe. Each 100,000 troops would cost more than P6.5 billion per year. While there are no gap projections beyond CY 67, economic stabilization is not likely to get much easier.

Piasters spent for US troops are piasters that cannot be spent for other purposes. The contribution to the military effort of these additional troops must be weighed against the contribution to the political effort of such actions as raising GVN salaries and to the military effort of RVNAF salary increases.

CONFIDENTIAL

73

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TABLE 1

END YEAR MONEY SUPPLY & RETAIL PRICE INDEX

<u>Year</u>	<u>Money Supply</u> <u>(P billions)</u>	<u>Saigon</u> <u>Retail Price Index</u> <u>1/</u>
1961	17.2	79.3
1962	19.5	83.0
1963	22.3	86.0
1964	27.4	93.4
1965	47.6	128.2
1966	67.0	208.9

1/ Mid-1965 = 100.

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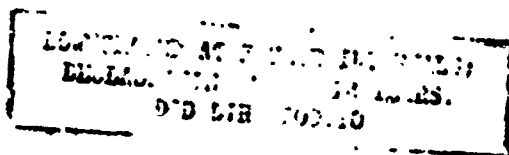
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TABLE 2

CY 67 GAP

16 March Embassy Estimate
(in P billions)

		OSD Est. Possible Gap
Monetary Injection		
GVN Military	P 44.8	P 45.7
GVN Civil	33.0	33.0
US Military	44.5	36.4
US Civil	8.0	10.0
Non-US Piaster Purchases	3.3	3.3
Exports	2.0	2.0
Credit Expansion	1.0	0
Subsidies	9.0	4.0
Total	<u>P145.6</u>	<u>P134.4</u>
Monetary Withdrawals		
GVN Imports	P 31.8	P 31.8
CIP Imports	18.9	18.9
Food for Peace	13.6	13.6
Special Rice Imports	8.1	8.1
Customs, Austerity and Perequation Revenues	19.6	19.6
Domestic Revenues	26.0	26.0
Invisibles	10.6	10.6
Total	<u>P128.6</u>	<u>P128.6</u>
GAP	<u><u>P 17.0</u></u>	<u><u>P 5.8</u></u>



May 15, 1967

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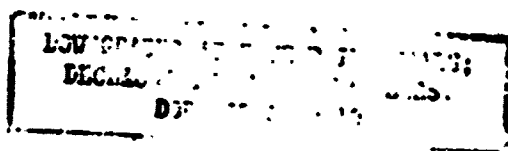
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TABLE 3
POSSIBLE CY 67 MONEY SUPPLY INCREASES AND
PRICE RISES

<u>CY 67 Gap</u>	<u>% Change in Money Supply ^{1/}</u>	<u>% Change in Prices ^{2/}</u>
10	15.8	19.0
15	23.7	28.4
17	26.8	32.2
20	31.5	37.8
25	39.4	47.3
30	47.3	56.8

1/ Changes as a percent of the end of CY 66 money supply net of MACV balances.

2/ Based on estimate that price rises will exceed money supply increases by a ratio of 1.2 to 1.



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TABLE 4
DOD PIASTER SPENDING CY 67

	<u>1st Q.</u>	<u>2nd Q.</u>	<u>3rd Q.</u>	<u>4th Q.</u>
Personal Spending				
Per man per month	\$24	\$24	\$24	\$27
Piasters (billions)	P 3.5	P 3.7	P 3.8	P 4.3
O&M Spending				
Per man per month	\$43	\$43	\$40	\$40
Piasters (billions)	P 4.2	P 4.5	P 4.2	P 4.3
Construction Spending				
WIP per month (millions)	\$40	\$40	\$36	\$27
Piasters (billions)	P 1.1	P 1.1	P 1.1	P .7
Total Piasters (billions)	<u>P 8.8</u>	<u>P 9.3</u>	<u>P 9.0</u>	<u>P 9.3</u>

CY 67 Total: P36.4 billion

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TABLE 5

RECENT SVN INFLATION

	<u>USAID Saigon Price Index</u>	
	<u>Including Rice</u>	<u>Excluding Rice</u>
<u>1966</u>		
1 Aug	219	226
1 Sep	215	224
1 Oct	209	216
1 Nov	225	232
1 Dec	230	234
<u>1967</u>		
1 Jan	225	228
1 Feb	254	253
1 Mar	255	250
1 Apr	261	246
1 May	250	247

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INFLATION IN SOUTH VIETNAM

Price Trends

Recent price trends in SVN are given in Table 1. Since the last SecDef trip to Saigon (October) prices have risen 32 percent. Since January 1, 1967, they have risen 24 percent or nearly 5 percent per month.

A large part of the increase in the price index since the beginning of CY67, however, has been caused by an increase in the price of rice which is independently determined by import policy (see Table 1). Temporarily low stockpiles of rice set off panic buying which drove rice prices from P1700 per kilo on January 1 to a high of P3900 per kilo in March. Presently the price of rice is P2650 per kilo.

A particularly sharp price rise of 8% occurred in May after three months of price stability (see Table 1). The factors behind it are as yet not entirely clear--the rise occurred in both the index with rice and without. A partial explanation is seasonality. The historical pattern shows prices rising significantly at the beginning of the year due to Tet, leveling off until late spring and early summer when the rice harvest has been sold, then rising throughout the rainy season.

Prices and Money Supply

Excluding shortages such as rice, price increases derive from increases in the money supply. Increases in the money supply will bring proportionate increases in prices if all else remains equal.

In SVN increases in prices have been less than increases in the money supply until about mid-1965 (see Table 2). In CY66, while the money supply increased +0.7 percent, prices increased 60 percent.

This disturbing trend has continued in CY67. Between January 1 and May 13 the price index without rice rose 10 percent (228 to 252) while the money supply increased only 6 percent (P65.4 billion to P69.0 billion).

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Currently then, price increases are exceeding money supply increases by a ratio of roughly 1.5 to 1. We are here faced with a potentially very dangerous situation. Disproportionate price increases most often result from a loss of confidence in the currency. This loss of confidence, due to previous inflation or political-military factors, causes people to shift from holding money to holding goods. People are willing to pay higher prices for goods which they expect will cost even more in the near future. To quote from the Joint Embassy-USAID May 1967 Spring Stabilization Review:

"It is emphasized that the damage inflicted by inflation is partly a function of the length of time it continues. We have had more than two years of more or less continuous inflation and we face a third. Inflation control will be more important during the next year than ever, and our ability to cope with the problem will be severely tested."

Money Supply Increases CY 67

Table 3 shows the target figures and latest projections for the CY67 gap (increase in money supply). At the time of the last SecDef trip to Saigon targets were being set which would permit a CY67 gap of P10 billion--a gap which, it was thought, would produce a "tolerable" degree of inflation. At that time USAID/OCO was given a target of P10 billion. SecDef agreed to a DoD target of P42 billion, and the target for all other agencies was set at P6 billion.

The latest Mission estimate of the CY67 gap is given in the second column of Table 3. The gap is now estimated to reach P26.4 billion in CY67. While the numbers in the latest Mission estimate may not all be correct, it is quite clear that we are now talking about a gap of an entirely different order of magnitude.

As can be seen in Table 3 the two principal reasons for the gap increase are (1) a lower estimate of imports and (2) an increase in GVN expenditures (principally for fertilizer and rice subsidies).

The U.S. Military contribution to reducing piaster expenditure has been exemplary. CINCPAC/COMUSMACV have reduced piaster spending significantly and have stayed within the quarterly ceilings established by SecDef.

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In fact, DoD piaster spending will be even further below the P42 billion target than estimated in Table 3. Rather than P39.8 billion DoD piaster spending in CY67 could be held to P35.2 billion. See Tab C. This would reduce the gap by P4.6 billion.

The best estimate of the CY67 gap is then P21.8 billion. At the current ratio of increases in prices to increases in money supply of 1.5 to 1, this would mean an inflation of 51 percent in CY67. But it may be worse. As the elections approach GVN expenditures may increase still further and the political uneasiness of the elections combined with rising prices may push the 1.5 to 1 ratio even higher.

Furthermore, the P21.8 billion gap is unevenly distributed throughout the year and at the end of CY67 will be running at an annual rate of P30 billion. The inflationary pressures at the end of the year will be very strong.

Whether or not we are on the verge of a runaway inflation in SVN as occurred in Korea, it seems that SVN has acquired an inflationary psychology. Price increases are exceeding money supply increases and in the political uncertainties of a multi-election year this ratio may increase. Under such circumstances a P20 billion to P25 billion gap is just too large.

More U. S. Troops

No proposed troop increase is likely to affect piaster spending much in CY67. Not many of the additional troops will reach SVN this year. Roughly P1 billion will "buy" 15,000 troops per year or 30,000 troops for six months, so the CY67 gap would probably not be increased by more than P1 to P2 billion.

But the long run implications of the proposed additions to Program #4 are much more serious. The yearly "cost" of an additional 85 thousand troops is P5.7 billion. An additional 200 thousand will "cost" P13.4 billion.

In CY67 economic stabilization is not likely to be any easier. Extending the gap projections from the end of CY67 into CY68 gives a preliminary gap estimate for CY68 of P31.6 billion. With the additional troops, the projected CY68 gap would be increased to P37.3 billion or to P45.0 billion. Addition to Program #4 will increase an inflationary pressure which is already too high.

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Table 1

SVN PRICE INDEX
(Jan. 1, 1965 = 100)

<u>1966</u>	<u>USAID Saigon Price Index</u>	
	<u>Index</u>	<u>Index Excluding Rice</u>
Aug 1	219	226
Sep 1	215	224
Oct 1	209	216
Nov 1	225	232
Dec 1	230	234
 <u>1967</u>		
Jan 1	225	228
Feb 1	254	253
Mar 1	255	250
Apr 1	261	246
May 1	260	247
Jun 1	278	266

Table 2

MONEY SUPPLY INCREASES AND PRICE INCREASES

<u>Calendar Year</u>	<u>Percent Increase Money Supply</u>	<u>Percent Increase Prices</u>
1962	13.4%	4.7%
1963	14.4%	3.6%
1964	22.9%	8.6%
1965	73.7%	37.3%
1966	40.7%	60.0%

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Table 3

CY67 GAP
(In P Billions)

<u>Plaster Creation</u>	<u>CY67 Targets</u>	<u>CY67 Latest Projection</u>
GVN		
Civil	25.0	26.5
Military	50.0	50.0
Subsidies	-	8.5
U.S.		
Civil	16.0	17.3
Military	42.0	39.8
Invisible Earnings	13.0	8.0
Exports	<u>2.0</u>	<u>2.0</u>
Total	148.0	152.1
<u>Plaster Absorption</u>		
Imports		
GVN	36.0	35.4
U.S.	50.0	35.3
Revenues		
Equalization		3.7
Customs & Austerity		0.0
Domestic Revenues		23.0
Perequation Tax		7.0
Subtotal	<u>42.0</u>	<u>43.7</u>
Invisibles	10.0	11.3
Total	<u>138.0</u>	<u>125.7</u>
Gap	<u>10.0</u>	<u>26.4</u>

5510

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Inflation, Wages and Incentives

In spite of controls on piaster spending, a piaster absorbing import program, etc., United States activities in Vietnam have caused high rates of inflation. Prior to the U. S. buildup, from June 1961 to June 1965, SVN consumer prices rose only 25%. Since June 1965, the price level has risen 190%, and is now roughly three times its earlier level. This year price increases through September have been 33%, or at an annual rate of 44%. Price increases in CY 68 are expected to be as high - perhaps 50%.

Not all wage rates have kept pace with this rate of inflation. Prior to June 1965, no group was badly hurt. From June 1961 to June 1965 GVN incomes, private sector incomes, and the price level rose about equally rapidly (see Table 1). But between June 1965 and December 1966, while prices increased 105% and private sector incomes increased 97% - 99%, GVN incomes increased only 20% - 30%. As a result, relative to the private sector, GVN incomes fell to between 53% and 66% of their 1961 level.

This decline in the income of GVN employees is reflected in the decline of their purchasing power. From January 1965 to June 1967, the real purchasing power of most GVN incomes, both civil and military, fell 47% to 54% in spite of GVN pay raises, ranging from 30% to 51% (see Table 2). The result has been a steady decline in the ability of the GVN civil service and military to maintain their past standards of living on their government incomes. Among some, the PF (P32,400 per annum) and provincial civil servants (P30,000 per annum), income is so low that physical energy and mental alertness may be reduced by lack of adequate diet, clothing and shelter.

Furthermore, the clearly inadequate GVN pay increases have, since November 1964, favored the lower level employees with higher percentage increases (see Table 2). Thus, the greatest declines in income have fallen to the key leadership groups within the GVN. In March 1965, a Colonel or upper level (Grade B) civil servant earned roughly the same annual income - P156,000 (see Table 3). By March 1967, their annual pay had risen to P187,000. However, the pay of other groups rose more and in 1967 the pay of a Colonel and Grade B civil servant was less than a secretary's (P221,220) or a draftsman's (P224,860), and was only slightly greater than that of a cashier (P172,705), or an accounting assistant (P164,904).

The effects on GVN performance of these changes in the income distribution have not been measured. However, the relative decline in GVN income is so striking that effects on GVN employees' ability, honesty, and devotion to their work seem likely.

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With incomes approximately half of private sector incomes, the GVN's appeal to able and industrious new employees is severely limited. Many GVN employees "moonlight" in the private sector. If confined to off duty hours, "moonlighting" might usefully supplement GVN employees' income while not reducing their effectiveness on GVN work. Unfortunately, much of it is done during GVN working hours.

In addition, the present wage differential gives GVN employees a real rationale for increasing their incomes through petty thievery, bribe-taking, and general corruption. While it is not clear that such "income supplements" would disappear if GVN pay were increased, corruption cannot be effectively attacked unless the economic need for it is lessened.

SVN's inflation has reduced GVN incomes and related incentives. To maintain or raise these incomes, a number of alternative combinations of GVN pay structure reforms, pay increases, and pay in-kind are possible. GVN income maintenance should be a key objective of U. S. economic policy in Vietnam.

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85

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TABLE 1

COMPARISON OF GVN AND PRIVATE SECTOR INCOME CHANGES (June 1961 Level = 100)

	June 1961	June 1965	Jun 61.-Jun 65 % Change	Dec 1966 ^{a/}	Jun 65-Dec 66 % Change
Skilled Employees' Incomes					
1. GVN ^{b/}	100	110	+10%	132	+20%
2. Private Sector ^{c/}	100	123	+23	245	+99
(1) as % of (2)	1.00	.89		.53	
Unskilled Employees' Incomes					
3. GVN ^{b/}	100	123	+23%	160	+30%
4. Private Sector ^{c/}	100	123	+23	242	+97
(3) as % of (4)	1.00	1.00		.66	
SVN Consumer Price Index ^{d/}	100	125	+25%	256	+105%

^{a/} Since March 1967, the average GVN employee has received a "rice bonus" pay increase of 15%. Private sector wage increases since December 1966 are not known. The increase may have been about equal to price increases - 30% to 35% - and greater than the GVN's increase of 15%.

^{b/} Civil servant incomes of High Grade B (for skilled) and High Grade C (for unskilled) were used. Though income increases vary widely by rank and family size, the increases shown are typical both of the civil service and ARVN employees.

^{c/} National Institute of Statistics (GVN) estimates of average daily wages used for the period from June 1961 - December 1966.

^{d/} Consumer price index including rent for lower class families was used. It is compiled by the NIS (GVN).

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TABLE 2.

MONEY INCOME ^{a/}
(Piasters)

	<u>Private</u>	<u>Cpl. 1</u>	<u>M/Sgt 1</u>	<u>1st Lt.</u>	<u>Colonel</u>
Jan 65	P38,988	P65,376	P89,854	P100,386	P162,085
Jun 65	38,988	65,376	89,854	100,386	162,085
Dec 65	38,988	65,376	89,854	100,386	162,085
Jun 66	50,684	82,345	112,318	125,482	194,502
Dec 66	50,684	82,345	112,318	125,482	194,502
Jun 67	58,844	94,385	128,638	134,362	210,302
% Increase	51%	43%	43%	34%	30%

REAL INCOME INCLUDING PAY INCREASES ^{b/ c/}
(Constant November 1964 Piasters)

	<u>Private</u>	<u>Cpl. 1</u>	<u>M/Sgt 1</u>	<u>1st Lt.</u>	<u>Colonel</u>
Jan 65	P38,360	P64,815	P88,407	P98,769	P159,475
Jun 65	35,537	60,375	81,901	91,502	147,740
Dec 65	27,396	46,291	63,140	70,541	113,897
Jun 66	26,650	43,297	59,057	65,978	107,054
Dec 66	21,190	34,423	46,960	52,464	81,321
Jun 67	20,619	33,072	45,075	47,080	73,689
% Decrease	-47%	-49%	-50%	-53%	-54%

a/ Includes base pay, family allowance, rice bonus, and Zone II cost-of-living adjustment.

b/ Real income is defined as money income restated in constant purchasing power units. Lower class cost-of-living index without rent compiled by the GVN (NIS) was used. Index with rent is not available on a current basis.

c/ Because closely similar pay increases have been granted to most GVN civil and military employees, the ARVN incomes and their changes are broadly representative.

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TABLE 3

TOTAL PAY OF ARVN AND SELECTED CIVILIANS ^{a/} ^{b/}
(Piasters)

	<u>Mar 65</u>	<u>Mar 66</u>	<u>Mar 67</u> ^{c/}
GVN Employees			
Colonel	P156,540	P156,540	P187,840
Grade B Civil Servant	155,160	155,160	186,192
Private Sector Employees			
Cashier	108,108	137,696	172,705
Accounting Assistant	98,956	113,620	164,904
Eng. Draftsman	93,704	109,720	224,860
Secretary	126,880	153,192	221,220
Interpreter	113,616	123,656	175,928

^{a/} GVN pay includes cost-of-living and family allowances
(Zone II) for soldier with 3.7 dependents.

Private sector incomes computed from MACV wage surveys
of these dates. They include computable fringe benefits
and allowances but not overtime or pay-in-kind. It was
assumed for comparability that each worker had 3.7
dependents - the average number of dependents of an
ARVN Colonel.

^{c/} Data on private sector income changes since March 1967
is not available.

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Feb 68

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SUMMARY OF INFLATION IN RVN DURING CY 1967

Highlights of CY 67

1. The 41% change in the price level in CY 67 was significantly lower than either the 55% change in CY 65 or 59% change in CY 66.
2. Accounting for these favorable developments has been:
 - a. Decrease in the gap between injections and absorptions from P20.1 billion in CY 66 to P17.5 billion in CY 67.
 - b. Increased absorptive power of imports brought about by the devalued piaster - twice as great as CY 66 (P83.4 billion in CY 67 to P41 billion in CY 66).
 - c. No decline in the supply of domestically-produced goods. Industrial production rose in CY 67. Agriculture output remained fairly constant despite gains in vegetables, pork and fish.
 - d. The success of MACV in staying within its piaster spending ceilings.
3. The GVN is still doing little to control inflation. This failure was conspicuous in three areas:
 - a. Budgetary tax proceeds rose only slightly more than the rate of price inflation (53% to 41%).
 - b. GVN spending exceeded its established ceilings by over 14%.
 - c. The GVN didn't raise the incomes of its civil servants and the military as rapidly as inflation. The real incomes of key employees fell 40% to 50%.
4. Foreign exchange and gold markets have been stable, with the piaster appreciating in terms of the dollar and gold.

Introduction

In comparison to other great wartime inflation, SVN's inflation in SVN has not been especially severe, as Table 1 shows. SVN's price level has increased a little over 3-fold since 1964. China experienced a 2,000-fold increase in prices during its civil war and the Japanese invasion, 1937-45. Korea, similar to SVN in that its territory was partially occupied, it employed no wage and price controls, and it received substantial U. S. aid, experienced a 25-fold increase in prices in the war period 1950-53.

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TABLE 1
COMPARISON OF WAR INFLATIONS

<u>a/</u> <u>China</u>		<u>b/</u> <u>Korea</u>		<u>c/</u> <u>South Vietnam</u>		<u>c/</u> <u>South Vietnam</u>	
<u>Year</u>	<u>Price Index</u>	<u>Year</u>	<u>Price Index</u>	<u>Year</u>	<u>Price Index</u>	<u>Year</u>	<u>Price Index</u>
1937	1.00	1947	1.00	1960	1.00	1949	1.00
1938	1.22	1948	1.68	1961	1.06	1950	1.05
1939	2.43	1949	1.51	1962	1.09	1951	1.18
1940	5.22	1950	3.19	1963	1.17	1952	1.38
1941	12.33	1951	24.52	1964	1.21	1953	1.79
1942	41.80	1952	60.51	1965	1.40	1954	2.10
1943	144.00	1953	79.48	1966	2.58	1955	2.30
1944	478.00			1967	3.93		
1945	1,919.00						

a/ A. Young, China's Wartime Inflation, 1937-45, Harvard University Press, 1965.

b/ L. Aspin, Korea and Vietnam: Some Economic Comparisons, OASD(SA), January 1967.

c/ National Institute of Statistics, Saigon 1967.

Nevertheless, inflation in South Vietnam continues to exceed a rate consistent with a successful stabilization program (see Table 2). However, the 41% price rise in CY 67 was an improvement over the 59% increase in CY 66 and the 55% increase in CY 65.

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TABLE 2

COMPARATIVE PRICE INFLATION BY INDEX AND MAJOR COMPONENTS

	CY 65			CY 66		USAID, CY 67						
	USAID		a/b/	USAID	NIS	1st	2nd	3rd	4th	1st	2nd	Year
	a/NIS					Qtr	Qtr	Qtr	Qtr	Half	Half	
General												
Index	+44%	+55%		+56%	+59%	20%	3%	15%	-.3%	24%	14%	41%
Food Sub												
Index	51	72		60	61	27	17	4	-3	50	1	51
Non-Food												
Index	30	29		50	54	5	3	4	6	8	10	19

a/ Reference points for USAID index percentage change are January 1, 1965, January 3, 1966, and January 3, 1967. For the NIS index, which is published monthly, the CY changes are calculated from index numbers for January 1965, 1966, and 1967.

b/ The NIS index used is the lower income index without rent.

Analysis of Stabilization Efforts

Inflationary pressure was reduced by a smaller "gap" between monetary expenditures and absorptions in CY 67 than in CY 66, as Table 3 shows. The currency devaluation of June 1966 and the imposition of piaster spending ceilings are the key to this result and to the entire stabilization effort. Table 3 reveals that the piaster absorbing powers of imports rose from P41.0 billion in CY 66 to P83.4 billion in CY 67, largely because of devaluation.

TABLE 3

MONETARY INJECTIONS AND ABSORPTIONS, 1966-67 (P Billion)

	1966	1967
<u>Injections</u>		
GVN Expenditures	P61.1	P85.6
U. S. Expenditures	34.0	54.7
Exports (including invisibles)	8.0	11.2
Changes in Domestic Credit	4.4	1.9
Total Injections	<u>P107.4</u>	<u>P153.4</u>
<u>Absorptions</u>		
GVN Revenue	78.0	49.3
Imports (including invisibles)	41.0	83.4
Changes in Time Deposits & Commercial		
Bank Capitalization	8.3	3.2
Total Absorptions	<u>P87.3</u>	<u>P135.9</u>
Net Gap	<u>P20.1</u>	<u>P17.5</u>

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Table 4 reviews the degree of success in conforming with piaster spending ceilings. The planned "gap" was P10.0 billion. The gap is now estimated to be P17.5 billion. Hence, the actual inflationary pressure was greater than that planned. This P7.5 billion deterioration is due to the failure of the GVN and the U. S. civil spending programs to stay within ceilings. The GVN exceeded their ceilings by 14% and U. S. civil spending by 11%. On the other hand, MACV kept well within its ceilings.

TABLE 4

CEILINGS VS. ACTUAL MONETARY INJECTIONS AND ABSORPTIONS^{a/}
FOR CY 1967
(P Billion)

	<u>Ceilings</u>	<u>Actual</u> ^{b/}
<u>Injections</u>		
GVN	P75.0	P85.6
U.S.		
Civil	16.0	17.7
Military	42.0	37.0
Exports		
Commodity	2.0	2.4
Invisibles	13.0	8.8
Changes in Domestic Credit	-	1.9
 Total Injections	 <u>P148.0</u>	 <u>P153.4</u>
	<u>Estimated</u>	<u>Actual</u>
<u>Absorptions</u>		
Imports	P86.0	P71.6
Invisible Outlays	10.0	11.8
Revenues	42.0	49.3
Changes in Import Margin Deposits	-	-1.3
Changes in Time & Savings Deposits	-	3.3
Changes in Bank Capitalization	-	1.2
 Total Absorptions	 <u>P138.0</u>	 <u>P135.9</u>
 Net Gap	 <u>10.0</u>	 <u>17.5</u>

a/ Source: Spring and Fall Stabilization Review.

b/ Based upon first half and projected second half data.

Successful stabilization also depends on a tax program. Table 3 shows that total tax revenue in CY 67 rose about 30% over CY 66, less than the rate of inflation. However, total budgetary revenue (including domestic, miscellaneous, and customs sources) rose about P24.3 billion to P37.3 billion, or 53%. The extra-budgetary revenue (from perequation, equalization, lottery, and economic consolidation sources) declined from P13.7 billion in CY 66 to P12.0 billion in CY 67. Thus, while the real purchasing power of the total tax revenue in CY 67 was less than that of CY 66, the GVN is making an effort to increase tax yields from more traditional sources to offset the decline from extra-budgetary sources.

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Of further importance to the success of the stabilization effort was the increase in the supply of domestically-produced goods. Table 5 shows that over-all industrial production increased during CY 67. The projected index for CY 67 stands at 191 compared to 171 in CY 66 and 158 in CY 65. However, much of this rise in the general industrial index was in the areas of tobacco, beverages, and plastic articles production.

TABLE 5
INDEX OF INDUSTRIAL PRODUCTION^{a/}
(1962 = 100)

	1965	1966					1967		
		1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	Year	1st Qtr	2nd Qtr	Half-Year Average
General Index	158	174	181	163	165	171	180	202	191
Mfg. Industry	160	178	184	164	166	173	183	204	194
Foodstuffs	106	123	113	108	116	115	112	141	127
Beverages	182	214	217	173	154	189	212	233	223
Tobacco	148	156	161	151	217	171	209	197	203
Textiles	162	148	169	182	180	170	147	156	152
Clothing	93	102	149	128	129	127	130	162	146
Paper	146	166	163	284	264	219	107	144	126
Rubber Products	145	123	133	132	123	128	114	122	118
Plastic Articles	358	360	482	448	491	445	494	604	539
Electricity	168	158	174	179	184	174	177	202	190

^{a/} Source: National Institute of Statistics/USAID Annual Statistical Bulletin No. 10.

In agriculture, over-all output remained fairly constant despite increases in the production of vegetables, port and fish, as shown in Table 6.

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TABLE 6
SUMMARY OF AGRICULTURAL PRODUCTION^{a/}
1965-1967

	<u>1965</u>	<u>1966</u>	<u>1967^{b/}</u>
Agricultural Crops			
Paddyrice (mil met tons)	4.8	4.3	4.3
Manioc (th tons)	236	280	280
Sweet Potatoes (th tons)	278	246	246
Sugarcane (mil tons)	1.1	1.0	1.0
Peanuts (th tons)	33	34	34
Rubber (th tons)	61	49	44 ^{c/}
Tea (th tons)	6	5	4
Vegetables (th tons) ^{d/}	133	144	158
Animal Products			
Pork (Controlled Slaughtering, th head)	1,249	1,093	1,145 ^{e/}
Fish	375	381	396 ^{f/}
Timber Production (th m)	318	263	205 ^{c/}

- ^{a/} Source: National Institute of Statistics.
^{b/} Approximate data for CY 67.
^{c/} Based on first seven months output in 1967.
^{d/} Provided by the Directorate of Agricultural Affairs.
^{e/} Extrapolated from eight months slaughtering in 1967.
^{f/} Estimated by USAID in Agricultural Budget request for CY 69.

Price Increases by Sector

The greatest percentage increase in prices in 1967 (as in 1965-66) in the food sector. Over 80% of the price increase in CY 67 can be accounted for by food price increases, particularly protein foods.

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TABLE 7

PERCENT OF THE USAID AND NIS GENERAL INDEX CHANGES DUE TO
FOOD, RICE AND PROTEIN: FOOD GROUP PRICE CHANGES

	CY 65		CY 66		CY 67 to Nov 6
	USAID	NIS	USAID	NIS	USAID
Food	76%	80%	72%	70%	82%
Rice	-1	8	23	25	15
Protein	56	45	36	25	62

Money Supply and the Price Level

Changes in the money supply are often used as first approximations for changes in the price level. However, a 1 to 1 relationship between changes in the price level rarely holds. During inflation the purchasing power of money erodes and people hold less of their assets in cash form. This increases the rate at which each dollar is spent and, as a consequence, the rate of price change can be greater than the rate at which the money supply increases. Table 8 reveals that the 1 to 1 relationship has not held in RVN. Nevertheless, with more work and identification of key variables the relationship should be predictable allowing better prediction of price changes.

TABLE 8

COMPARATIVE CHANGES IN THE MONEY SUPPLY^{a/}
AND PRICE LEVEL^{b/}

	CY 1965	CY 1966	CY 67						Year
			1st Qtr	2nd Qtr	3rd Qtr	4th Qtr	1st Half	2nd Half	
Changes in Price Index	+44%	+56%	20%	3%	15%	-.3%	24%	14%	41%
Changes in Money Supply	74	37	7	4	36	11	11	14	27

- ^{a/} Money supply defined as sum of notes in circulation and private demand deposits.
^{b/} USAID index of Saigon retail prices.

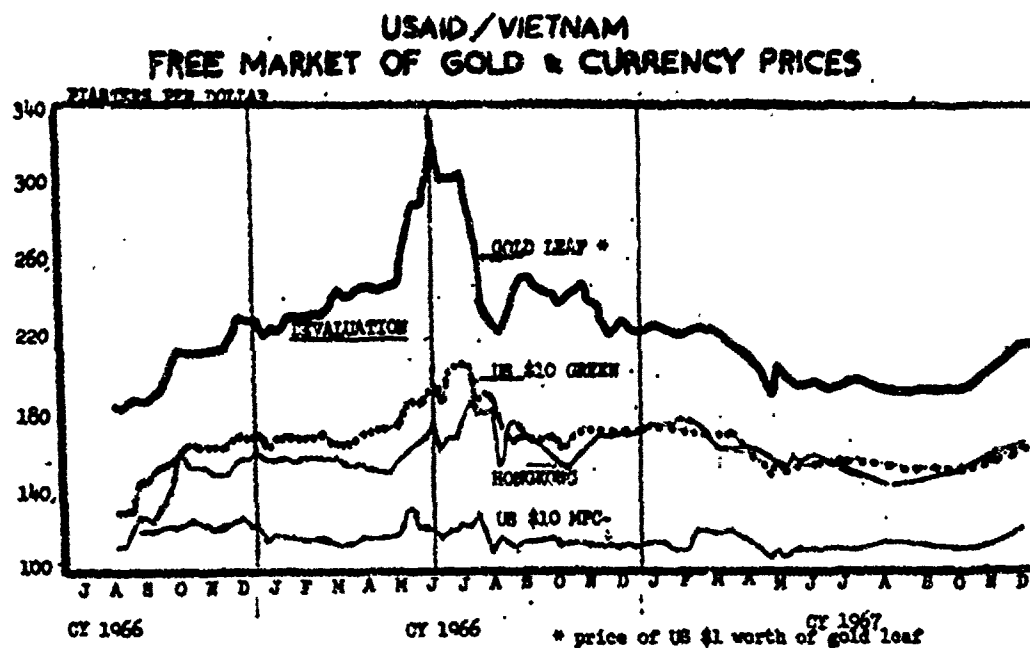
The Foreign Exchange Market

When people expect inflation, they buy those items whose value does not suffer from the resulting currency depreciation, including gold and stable foreign currencies. Chart 1 shows how quickly and how great can be the depreciation of the piaster relative to gold and foreign currencies. The

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piaster depreciated sharply in CY 65-66 but recovered in CY 67 in terms of both gold and the dollar. 1/ Moreover, relative stability characterized these markets.



1/ Expectations concerning the piaster's future purchasing powers will only influence the demand for gold and foreign exchange. But the piaster price of these goods is also determined by their supply. Hence, the piaster could have appreciated in terms of gold and foreign currency because the supply of these goods increased relative to any increase in their demand.

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Effects of Inflation ^{2/}

Inflation usually affects some wages, prices, and incomes more than others. This alteration in the relative wage, price, income structure need not be harmful. It may promote the movement of people and skills from areas of underemployment or less efficient employment to areas where they are used more efficiently. This can result in a net increase in a nation's output. However, this alteration also can be distinctly harmful. Individuals whose incomes are fixed for given time periods or who hold assets in money are harmed by inflation. This can lead to attempts to offset the loss by acceptance of bribes and kickbacks. Widespread corruption in the GVN is public knowledge. The temptation to sell official favors has been due in part to the decline in real income of public sector employees. Key employees have seen a decline in real income as high as 40 to 50%. In general, inflation has redistributed income away from the public sector to the private sector, and within the private sector from the rural farmer to the urban worker.

Inflationary Prospects for CY 68 in SVN

Given the effects of the Tet offensive, inflationary pressures will be at least as great in CY 68 as in CY 67 and will probably be greater. Estimates of the rate of inflation range from 40-80% assuming no more troops are deployed. Each 100,000 additional add at least 3% to the rate of inflation. Additional projections will be made in the March SEA Analysis Report.

^{2/} For an extensive discussion of the subject in this Section, with appropriate statistical measures, see "Inflation, Income, and Incentives in Vietnam, Southeast Asia Analysis Report, Special Supplement: Selected Articles from 1967, P110.

CONFIDENTIAL

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June 68

WAGE AND REAL INCOME CHANGES IN SOUTH VIETNAM

In November, we published an article pointing out that wages of GVN employees and military personnel were lagging badly behind the cost of living. This article provides the results of further research on this problem.

Since 1966, U. S. civil and military agencies have increased their wages (including overtime and upgrading) at least as rapidly as prices and South Vietnamese private sector wages. The wages of GVN civil servants and military have also increased by 30% - 68%. However, the increases in prices have been much more rapid. By June of 1965 and 1967, the average real wage of GVN employees was cut about 50% by inflation.

U. S. and private sector employees of all levels are better paid, including bonuses, overtime, upgrading, etc., than employees of the GVN, either civil or military. This differential is increasing.

U. S. Wages

Since June 1966, the U. S. has increased its average local national wage including overtime, bonuses, etc., by 80%. Wage rate increases only were 41%, the other half of the increases was through overtime, upgrading, etc. Consumer prices have risen by only 68% over the same period. Consequently, the U. S. Government employed Vietnamese had their real average wage increased by 7%.

	Permanent ^{a/} Hire Wages (P/Man/Month)	% Change Over Jun 66	Cost of Living Index 1959=100	% Change Over Jun 66
Jun 66	25,992		234	
Dec 66	6,694	11.7%	294	25.5%
Jun 67	3,460	41.2	351	50.0
Dec 67	10,800	80.2	393	68.0

^{a/} Temporary hire wage rates have not increased over this period.
Source: DOD Activities Cost Index Reports, MACV.

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U. S. WAGES FOR LABOUR (June 1966 = 100)

	<u>Official Wage Rates</u> ^{a/}	<u>Actual Take Home Pay</u>
Jun 66	100	100
Dec 66	111	112
Jun 67	122	141
Dec 67	141	180

a/ The U. S. increase in wage rates following the Locality Wage Survey is here assumed to be 15%. The exact value is not known.

Because the U. S. Government has increased its wages as rapidly as prices, it has been able to maintain low or declining job vacancy rates, and increase its labor force in spite of general labor shortages.

U. S. AGENCY EMPLOYMENT

	<u>Civil</u>		<u>Military</u>	
	<u>Employment</u>	<u>Vacancies (%)</u>	<u>Employment</u>	<u>Vacancies (%)</u>
Sep 66	2,440	22.6%	67,508	4.1%
Dec 66	2,562	30.6	76,446	15.0
Sep 67	4,531	10.5	83,538	5.4
Dec 67	4,842	12.0	90,043	5.3

MACV and the service contractors, the largest employers of the U. S. agencies, appear to have had a vacancy rate of only about 5%, in spite of steady increases in their work force.

Because of rapid increases in their incomes, U. S. employees, (on the average), are substantially better paid than either GVN civil servants or the military.

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AVERAGE ANNUAL WAGE - 1967 (P/Man/Year)

U. S.	P101,520 ^{a/}
GVN Civil Servants	64,000 ^{b/}
ARVN	69,000 ^{b/}
RF	34,700 ^{b/}
PF	29,000 ^{b/}

a/ June 1967, DOD Activities Cost Index data.

b/ Derived from the Civil and Military Recapitulation Budgets for 1967 by dividing total salary payments by total manpower.

These differences in the average level of U. S. and GVN wages are not attributable to differences in the quality of their work forces. The composition of the GVN civil work force indicates a skill level higher than that of the U. S. work force and yet the U. S. work force is paid about 60% more on the average.

Occupation	GVN Civil Service		U.S. Employment	
	Number of Employees ^{a/}	Percent of Total	Number of Employees ^{a/}	Percent of Total
Admin & Managers	1,294	1%	45	0%
Professional, Technical & Related	64,038	29	8,224	7
Clerical	22,025	10	16,866	13
Skilled & Semi-skilled	105,323	48	52,294	41
Unskilled	24,419	12	49,989	39
Total	217,099	100%	127,418	100%

a/ GVN statistics, September 1967; U.S. statistics, June 1967.

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SVN Private Sector Wages

Wages in the South Vietnamese private sector appear to have risen a little less rapidly than Saigon prices.

PRIVATE AVERAGE DAILY WAGES a/ b/
(June 1965 = 100)

	<u>Skilled</u>	<u>Unskilled</u>	<u>Prices</u>
Jun 65	100	100	100
Dec 65	121	117	130
Jun 66	151	148	174
Dec 66	199	197	218

a/ Source: National Institute of Statistics (GVN).

b/ Includes base pay, payments-in-kind, and bonuses, but not overtime or family allowances. The increase including overtime and allowances would be greater than that shown above.

However, given the sampling errors in both wage and price information, it is quite likely that the real wages of private sector employees have remained at least constant rather than decreasing about 10% as the data above indicate. However, in either case, it appears that average U. S. wages, including the effects of overtime and upgrading, have risen relative to both prices and the wages paid to Vietnam's private sector employees. This general pattern is also consistent with the ability of the U. S. to increase its labor force at will, its low vacancy rate, and the willingness of some Vietnamese to pay bribes in order just to obtain a job with a U. S. contractor or agency.

Detailed data on private sector wage changes since December 1966 do not exist; however, it is reasonable to expect that these wages have followed their consistent historical (1961-66) pattern and continued to rise roughly as rapidly as prices.

GVN Military and Civil Wages

Since June 1965, individual civil servants in the GVN have received wage increases (including bonuses, allowances, etc.) of from 30% to 68%. The salary of the average civil servant has increased by 38%.

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Civil Service Category	Percent Wage Increase ^{a/} (Jun 65 - Jun 67)	Percent Civil Service in Each Category ^{b/}
A	30%	3.6%
B	33	32.0
C	41	62.5
D	68	1.9
Weighted Average	38%	-

a/ Midpoint of % increase range in each category. Exact percentages are shown on Table 3 in "Incomes, Incentives, and Inflation", by John Court.

b/ March 1967 Treasury Data Processing Payroll System report.

However, in spite of these pay increases, the average civil servant has suffered a 50% decrease in real income since June 1965, while real wages in the private sector and among U. S. employees remained constant or even rose slightly.

	Civil Service Average Wages ^{a/} (Jun 65 = 100)	Consumer Prices (Jun 65 = 100)	Real Wage (Jun 65 = 100)
Jun 65	100	100	100
Jun 66	125	173	72
Jun 67	138	270	51

a/ Based on wage rates including salaries, bonuses, allowances, etc.

Thus, for the average civil servant, GVN-granted pay increases have not offset either price increases or the increases in U. S. and private sector employees' wages.

The GVN's military has suffered losses in income almost identical to its civil servants. In real terms, even members of ARVN (the best paid service) has lost from 47% to 54% of their income since 1965 in spite of large pay increases, particularly to the lower ranks.

CONFIDENTIAL

ANNUAL REAL PAY
(Constant 1964 Piasters)

	<u>Private 1</u>	<u>Colonel</u>
Jun 65	38,360	159,475
Jun 66	26,650	107,054
Jun 67	20,619	73,689
Percent Decrease	-47%	-54%

Both in real pay and relative to private sector wages, the GVN military has shared the fate of the civil service - large and persistent cuts in income.

In addition, the increases in wage rate given civil servants, unlike that of U. S. employees, have not been augmented by large-scale upgrading and overtime. In fact, the average total payments per GVN civil servant have risen since 1965 at about the same rate as the official wage rates.

GVN CIVIL SERVANTS' WAGES ^{a/}
(1965 Average = 100)

	<u>Per Capita Payments</u>	<u>Wage Rates</u>
1965	100	100
1967	133	138

a/ Both payment and wage estimates include basic salary, allowances, benefits, and cost-of-living adjustment.

In contrast to the low and declining job vacancy rates experienced by the U. S., the GVN civil service has had rather high vacancies.

103

CONFIDENTIAL

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VACANCIES IN GVN CIVIL SERVICE

March 1967 ^{a/}			September 1967 ^{a/}		
Employee Type	Employment	Vacancy as % of Employment	Employee Type	Employment	Vacancy as % of Employment
Career	43,875	19%	Managers	1,294	6%
Contract	3,076	31	Professional	64,038	7
Daily	32,097	48	Clerical	22,025	14
Floating	113,351	7	Skilled	105,323	12
			Unskilled	24,419	11
Total	192,399	17		217,099	11

^{a/} Manpower Staff AID/VN.

The vacancy rates for GVN employment appear to be two to three times as large as those of the U. S. military services and their contractors (the major U. S. employers in Vietnam). In contrast, U. S. civil agencies and their contractors have vacancy rates close to those of the GVN civil service, though their manpower needs are small by comparison.

Structure of GVN Wage-

Although GVN real incomes have been lowered across the board by inflation, the greatest decrease has been experienced by senior military officers and high civil servants. For instance, in March 1965, a Colonel or Grade B civil servant earned roughly the same income - P158,400. Then, their pay level was substantially greater than that for private sector employees such as a draftsman (P93,704), cashier (P103,103), or secretary (P126,880). By March 1967, the pay of these key employees was less than a U. S.-employed secretary or draftsman and only slightly greater than a U. S.-employed cashier, accounting assistant, or interpreter.

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ANNUAL TOTAL PAY (In Piasters)

	<u>Mar 65</u>	<u>Mar 67</u>	<u>Percent Change</u>
Colonel or Grade B			
Civil Servant	P156,540	P187,848	20%
U.S. Cashier	103,103	172,705	60
U.S. Accounting			
Assistant	93,953	164,904	67
U.S. Eng. Draftsman	93,704	224,860	140
U.S. Secretary	126,820	221,220	74
U.S. Interpreter	113,616	175,928	55

Since March 1967, the Colonel and the civil servants have received pay increases of about 6%. Over the same period (Mar 67 - Dec 67) prices and private sector wages have probably both increased 17%.

In short, the middle and upper leadership have been subjected to a large-scale decrease in their real incomes since 1965. The magnitude of this decrease is roughly 50%.

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July 68

THE ECONOMIC SITUATION IN VIETNAM FOR THE FIRST SIX MONTHS OF 1968

Inflation in South Vietnam continues, but at a rate well below expectations. Although the money supply is rapidly increasing, consumers appear to be hoarding piasters instead of spending them (possibly as a hedge against war damage). Credit outstanding to private business is still well below last year's level, suggesting continued uncertainty. Rice deliveries from the Delta to Saigon are at a ten-year low because of depressed paddy prices and insecure transportation. As long as large piaster balances remain in public hands, and market supplies of goods continue to decline, the potential for a sharp inflation will be present.

Prices and Money Supply

During the first half of 1968, the money supply increased steadily, rising 31%, while the USAID price index for Saigon fluctuated erratically. Prices increased significantly during the February and May offensives, but declined as security and transportation were restored. Overall, the rate of inflation during the first half of 1968 was about 17% less than the rate in the same period in 1967 (20% this year versus 24% in 1967). This lower rate occurred despite an increase in the money supply at twice the 1967 rate.

USAID PRICE INDEX, SAIGON, ALL ITEMS

(January 1, 1965 = 100)

	Dec	Jan	Feb	Mar	Apr	May	Jun	Percent Change Dec-Jun	Last 12 Months
1967	216 a/	254	255	260	254	278	267	24%	
1968	305 a/	326	360	328	351	389	367	20	37%

a/ December figure for prior year.

MONEY SUPPLY

(Billions of Piasters)

	Dec	Jan	Feb	Mar	Apr	May	Jun	Percent Change Dec-Jun	Last 12 Months
1967	63.5 a/	69.1	71.6	70.0	71.2	71.1	72.8	15%	
1968	82.7 a/	90.7	96.5	100.3	101.7 b/	108.9 b/	108.4 c/	31	49%

a/ December figure for prior year.

b/ Preliminary.

c/ To June 22.

OASD(SA)
Economics & Resource Analysis

CONFIDENTIAL

106

CONFIDENTIAL

We still expect the rate of inflation in the second half of 1968 to be greater than in the first half. This is based on a projected monetary gap in the second half of 1968 of P26.9 billion as opposed to P21.6 billion in the first half. In addition, there has been a buildup of cash balances in the hands of the public, as indicated by the disparity between the rate of growth in the money supply and price level changes.

Tax Revenue

Tax collections for the first half of 1968 were P15 billion, 3.4% more than in the first half of 1967. However, tax revenue in terms of real purchasing power declined approximately 26% from last year, hampering the stabilization effort. Revenue from direct taxes (personal and corporate income taxes) increased 36% in real terms, primarily as a result of improved collections. However, revenue from all other taxes declined in real terms by 31% because of the depressed level of economic activity.

GVM TAX PROCEEDS (P Billion)

	<u>Jan-Jun 1967</u>	<u>Jan-Jun 1968</u>		<u>% Change</u>	
		<u>Current</u>	<u>1967</u>	<u>Current</u>	<u>1967</u>
		<u>Value</u>	<u>Value ^{a/}</u>	<u>Value</u>	<u>Value ^{a/}</u>
<u>Internal Taxes</u>					
Excise	P3.1	P2.9	P2.1	-8.2%	-32.3%
Indirect	2.5	2.3	1.6	-7.7	-36
Registration	1.5	1.3	.9	-16.5	-40
Direct	1.1	2.1	1.5	+94.9	+36.4
<u>External Taxes</u>					
Customs	<u>6.3</u>	<u>6.4 ^{b/}</u>	<u>4.6</u>	<u>+1.6</u>	<u>-27</u>
Total	14.5	15.0	10.7	+3.4%	-26.2%

^{a/}In terms of 1967 prices (adjusted for 40% inflation).

^{b/}P5.3 billion for January-May projected through June.

Private Business

A pessimistic outlook continues in the business community; credit outstanding to the private sector of the economy remained fairly constant over the past six months at approximately 19% below the 1967 level.

CONFIDENTIAL

CREDIT OUTSTANDING TO THE PRIVATE SECTOR (P Billion)

	<u>Jan</u>	<u>Feb</u>	<u>Mar</u>	<u>Apr</u>	<u>May</u>	<u>Jun</u>
1967	31.2	32.9	33.2	33.7	32.6	31.8
1968	26.2	27.3	26.8	25.7	26.4	25.7 ^{a/}

^{a/} To June 22.

Agriculture

Preliminary data on rice deliveries from the Delta to Saigon indicate that the flow of rice declined in May after a partial recovery in March and April. Rice deliveries in May were approximately 16-20,000 metric tons compared with 23,500 and 22,000 tons in March and April, respectively. Deliveries in the first five months of 1968 were about 88,000 tons, 40% below deliveries during the same period last year and 60% less than the average for the same period in 1964-66. The major reasons for this decline seem to be the continuing low price of paddy in the Delta and the greater risks and consequently higher costs of transporting it.

The IR-8 planting program is expected to be 15-20% less than anticipated (35,000-37,000 hectares versus a 44,000 hectare goal).

CONFIDENTIAL

Sep 68

CONFIDENTIAL

BUDGETARY AND FOREIGN EXCHANGE IMPACT OF THE CIVILIANIZATION PROGRAM

Under Program #6, COMUSMACV is required to "civilianize" 12,545 U.S. military spaces. Using Vietnamese direct hire personnel, MACV believes it must hire 19,000 Vietnamese (using a ratio of 1½ Vietnamese nationals for each U.S. military personnel). On this basis civilianization will save \$133.7 million per year, but increase the annual foreign exchange outflow by \$8.6 million. (See Table 1).

Several assumptions have been made in the analysis. First, we assume that the Program 6 troop ceiling would have been 12,545 men higher if not for civilianization. Second, the cost factors for non-combat U.S. troops are based on Army enlisted men at the E-4 level. These factors cover the full incremental costs of these men but exclude the high ammunition and attrition costs that are associated with combat troops. This is consistent with the MACV civilization program. Third, we assume the 12,545 U.S. military spaces have been taken out of Service active duty end strengths. If end strengths are not reduced, the savings would be cut by three-fourths. Finally, we assume all of the U.S. troops will be replaced by direct hire Vietnamese. Some spaces will be replaced by contractors, but the costs should not change appreciably.

TABLE 1
COST FACTORS AND CALCULATIONS:
PROGRAM #6 CIVILIANIZATION

<u>Personnel</u>	<u>Budgetary Impact</u>		<u>Balance of Payments Impact</u>	
	<u>Costs</u>	<u>Total</u>	<u>Expenditures</u>	<u>Total</u>
	<u>Per Man^a</u>	<u>Amount</u>	<u>Per Man^b</u>	<u>Amount</u>
		<u>(\$ millions)</u>		<u>(\$ millions)</u>
U.S. Military Personnel to be replaced:				
USA	9595	12,203	\$ 850	\$ 8.2
USMC	300	12,203	925	1.9
USAF	600	12,203	950	.6
USN	2050	12,203	975	.2
Total	12545	\$12,203	-	10.9
Vietnamese Nationals	19000	1,025	\$1025	\$19.5
Net Budgetary Savings		<u>\$133.7</u>		
Net Balance of Payment Costs		-		<u>\$ 8.6</u>
a/ U.S. Army Per Man Cost Factors				
Military Pay and Quarters (E-4)		\$3,377	(Includes basic pay, quarters, subsistence)	
Vietnam Cost Differential		2,500		
OMA Incremental (U.S.)		3,477		
OMA Incremental (Vietnam)		2,849	(Excludes support of Free World Forces)	
TOTAL		<u>\$12,203</u>		

Sources: ASA(FM) Cost Data Book (for pay and quarters); OASD(SA) E&RA (for Vietnam cost differential; DOD Instruction 7220.25 (for U.S. and Vietnam incremental OMA).

b/Source: OASD(Compt.), P/B IBP Directorate, May 10, 1968.

CONFIDENTIAL

Dec 68

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INFLATION IN RVN DURING 1968

Inflation in CY 68 was less than in the three previous years despite very adverse conditions arising from the Tet offensive. CY 69 raises the prospects of even greater price stability.

Highlights of CY 68

1. The 32% rise in the price level to mid-December 1968 was lower than the 37% rise in CY 67, the 56% rise in CY 66, and the 44% rise in CY 65.
2. Two factors account for this development:
 - a. The success of MACV in staying within its piaster spending ceilings (actual P34.0 billion vs. a ceiling of P37.8 billion) and the continued reduction in per capita spending by U. S. servicemen.
 - b. The sharp rise in import licensing during the second half of CY 68 to a rate some P25-P30 billion greater than CY 67. Although much of the absorption will occur in CY 69, large piaster balances have probably been built up to pay for the imports.
3. The rate of inflation was slowed despite the following problems:
 - a. The GVN budget deficit was almost twice as large as last year (P41.0 to P70.9 billion -- before the application of counterpart).
 - b. The real value of tax receipts received by the GVN were lower in CY 68 than in CY 67. The purchasing power of CY 68 tax receipts were 70% of CY 67 receipts.
 - c. Percentage change in the money supply was the greatest in the past three years (33% in 1966, 30% in 1967, and 47% in 1968).
 - d. The business community is still depressed since the Tet offensive and efforts to move large rice crops from the delta to Saigon are still handicapped.
4. Foreign exchange and gold markets have been subject to rising pressure with the piaster depreciating in terms of gold, U. S. green dollars, and MPC.
5. The outlook for CY 69 is for continued improvement in stabilizing the price level and expanding domestic production.

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Detailed Analysis

. While price inflation continues at a higher than desired rate, CY 68 represents an improvement over the previous three years even though the potential for a marked deterioration was present throughout the year (see Table 1).

TABLE 1

COMPARATIVE PRICE INFLATION BY MAJOR
COMPONENTS, USAID ALL COMMODITIES
INDEX ^{a/}
(Percentages)

	CY 65	CY 66	CY 67	CY 68	CY 68				3rd Qtr	4th Qtr
					1st Half	2nd Half	1st Qtr	2nd Qtr		
General Index	44%	56%	41%	32%	13.6	16.3	4.9	8.4	16.9	-.1
Food Sub-Index	51	60	51	36	13.4	20.0	4.9	8.0	21.5	-.1
Non-Food Sub-Index	30	50	19	22	14.1	6.5	5.0	8.7	4.7	1.7

^{a/} Reference points for the USAID index percentage changes are January 1, 1965, January 3, 1966, January 3, 1967, and January 1, 1968.

The potential for deterioration is to be found in the GVN budget deficit which in CY 68 is the largest of the war years (see Table 2). Since most of the deficit is financed by printing new paper currency, the money supply also rose sharply this year.

CONFIDENTIAL

111

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TABLE 2

GVN BUDGET DEFICIT AND NEW MONEY CREATION, 1965-68
(Billions of Piasters)

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969</u> ^{a/}
GVN Expenditures	P51.3	P61.4	P85.7	P110.0	P130.0
GVN Revenues	<u>17.0</u>	<u>40.0</u>	<u>52.7</u>	<u>49.1</u>	<u>66.0</u>
Deficit ^{b/}	34.3	21.4	33.0	60.9 ^{c/}	64.0
Change in the Money Supply	20.2	17.8	19.3	53.1 ^{c/}	
% Change in Money Supply as a % of Deficit	59%	83%	56%	87%	

^{a/} Estimated by Saigon Embassy.

^{b/} Some estimates of the GVN expenditures and deficits include the programs paid for by the piasters generated through the U. S. funded import program. If the U. S. aid chapter expenditures are included on the assumption that the GVN would maintain these programs in the absence of our funding, the GVN deficits would be, respectively, P37.3, P24.5, P41.0, P70.9, and P76.0.

^{c/} Estimated for CY 68.

While the GVN budget deficit is a major item generating inflationary pressure, it is only one of several items which has an impact on the Vietnamese economy. When these other items are considered (those increasing expenditures are called monetary injections while those withdrawing piasters from the economy are called monetary absorptions), the net difference, called the monetary gap, is markedly larger, in the absolute sense, than in the three previous years. The rate of new money creation, which measures the relative impact on the economy, is higher than in any year since 1965 (see Table 3).

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TABLE 3

MONETARY INJECTIONS AND ABSORPTIONS, 1965-70
(Billions of Piasters)

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>	<u>1969 ^{a/}</u>	
					<u>A</u>	<u>B</u>
<u>Injections</u>						
GVN						
Military		38.2	49.1	69.2	86.6	104.6
Civil		19.9	27.8	35.0	38.4	38.4
American AID		3.1	3.0	10.0	12.0	12.0
Subsidies		<u>3.3</u>	<u>8.5</u>	<u>5.8</u>	-	-
Subtotal		64.5	93.7	120.0	137.0	155.0
U. S.						
Military		31.2	38.8	39.9	44.3	49.3
Other Agencies		<u>3.7</u>	<u>3.9</u>	<u>9.9</u>	<u>9.0</u>	<u>10.0</u>
Subtotal		34.9	47.7	49.8	53.3	59.3
Exports		2.4	2.3	1.6	1.6	1.6
Invisibles		5.9	3.0	10.2	10.5	10.5
Bank Credit Expansion		<u>21.8</u>	<u>-2.0</u>	<u>-0.2</u>	<u>2.0</u>	<u>2.0</u>
Total Injections		<u>129.5</u>	<u>149.7</u>	<u>181.4</u>	<u>204.4</u>	<u>228.4</u>
<u>Absorptions</u>						
Imports		41.2	65.7	59.7	72.7	80.0
Invisibles		10.0	13.2	12.5	13.0	13.0
Internal Revenue		18.1	24.5	26.3	30.5	33.2
Import Taxes		21.9	23.4	22.8	27.5	30.9
Import Margins & Savings		17.2	1.3	4.0	6.0	6.0
Errors & Omissions		<u>3.3</u>	<u>2.7</u>	<u>3.0</u>	-	-
Total Absorptions		<u>111.7</u>	<u>130.4</u>	<u>128.3</u>	<u>149.7</u>	<u>176.0</u>
Gap (Change in Money Supply)	20.2	17.8	19.3	53.1	54.7	52.4
% Change in Money Supply	73.7%	33%	30%	66%	40%	39%

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TABLE 3, Continued

MONETARY INJECTIONS AND ABSORPTIONS, 1965-70
(Billions of Piasters)

Footnotes

a/ Model A: Minimum U. S. and GVN expenditures are assumed here which amounts to an assumption of a return to "normalcy" implying a moderate but steady growth in import demand and no increase in efficiency of the revenue system.

Model B: Assume (a) a 25% increase in salaries and allowances for all GVN and U. S. employees, (b) imports increased by U. S. \$150 million above the 1968 level, and (c) an increase in revenues resulting from greater imports and additional new taxes.

Model B presents the maximum expenditure level given present programs and the wage increase noted above. The absorptions side too is realistic since it projects an increase in revenues which would result from implementation of a few tax measures which could easily be effected.

Model B with a 51% increase in the money supply is probably the best approximation of what may actually happen.

Model C: Assume (a) an overall 25% increase in salaries and allowances, (b) a very large increase in imports reflecting the salary increases, and (c) very large revenues resulting from imposition of all of the U. S. suggestions for tax increases and new taxes.

Model C is realistic on the expenditures side but the absorptions showing a 50% increase in revenues is optimistic. However, this is the picture which would give everyone his salary increase, create a boom in imports, and at the same time, have a gap somewhat smaller than that of 1968. This is thus an unlikely possibility since it demonstrates that greatly increased spending by the government should, in the present circumstances, be accompanied by stringent revenue measures. Such things do not usually happen.

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In the past two years, the rate of change of the price level has been greater than the rate of change in the money supply (see Table 4). However, during CY 68, the opposite happened -- the money supply increased more rapidly than the price level. Throughout much of this year this phenomenon was referred to as the "liquidity overhang" and implied the buildup of piaster balances in the hands of the public. Its magnitude was estimated to be between P22 to P26 billion. ^{1/} Explanations given for this buildup of piaster balances mainly centered around the need to hold wealth

TABLE 4

MONEY SUPPLY AND PRICE LEVEL CHANGES AND
CRUDE RATES OF MONEY TURNOVER, 1965-68

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
Percentage Change in the Price Level <u>a/</u>	44%	56%	41%	33%
Percentage Change in the Money Supply	74	33	30	47
Crude Rate of Money Turnover <u>b/</u>	.59	1.7	1.4	.70

a/ USAID all-commodities index.

b/ Turnover rate computed by dividing price level changes by changes in the money supply.

in a cash form to avoid its destruction by either another Tet type offensive or the rocket shelling of urban areas by the VC. However, little evidence was forthcoming to substantiate this. Recent statistical evidence offers a counter proposition which explains away the "overhang" theory and centers on the unexpected sharp rise

^{1/} Derived by applying the crude rate of turnover in 1966 and 1967 to the change in the price level in CY 68 to get the theoretical change in the money supply. This then subtracted from the actual change to get the range of the "overhang".

CONFIDENTIAL

115

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in import licenses, especially those financed by the GVN. Table 5 shows that the licenses granted are valued at some \$232 million or about P27.4 billion higher than last year (this amount is very close to estimated amount of the "overhang"). Since a large amount of this rise in import licensing is GVN-financed, the time lapse between licensing and absorption will be shorter than if U. S.-financed imports rose (2 months vs. 3 months). Since this

TABLE 5
IMPORT DATA
(Millions of Dollars)

	<u>Through November</u>	
	<u>1967</u>	<u>1968</u>
Import Licenses		
GVN	\$262.8	\$450.1
CIP	73.6	154.6
PL-480	<u>136.4</u>	<u>100.0</u> a/
	<u>\$472.8</u>	<u>\$704.7</u>
Import Absorptions	<u>\$556.8</u>	<u>\$505.9</u> b/

a/ Estimated.

b/ Estimated in April 1968.

unexpected sharp rise in licensing is occurring in the last part of CY 68, the absorption will take place early next year. However, because of the shorter time between licensing and paying for the imports, it is believed that plaster balances are being built up currently to pay for the imports. This is of fundamental importance for stabilization. The decline in the crude rate of money turnover shown in Table 4 on which the "overhang" theory depends neglects the fact that imports are rising substantially above last year.

Several major problems continue to hamper stabilization efforts.

1. First is the GVN's large budget deficit which was twice as large as last year and the largest thus far in the war. If the expenditure levels are the minimum necessary, then the deficit can only be reduced by raising taxes. It is

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116

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in this area that the GVN has been noticeably weak. The domestic tax revenue comes mainly from various excise taxes on tobacco, beer and soft drinks. About half the total tax revenue comes from various types of taxes levied on imports. The trend in total real tax receipts (nominal taxes deflated by the rise in prices) from 1955 to the present has been downward (see Table 6).

The reasons for the revenue problems are well known (narrow tax base, lack of trained personnel, GVN reluctance to tax and inertia to change). The U. S. could exert pressure, perhaps by withholding counterpart funds, for fundamental reforms.

TABLE 6

REAL TAX REVENUE, 1965-68
(Billions of Piasters)

	<u>1965</u>	<u>1966</u>	<u>1967</u>	<u>1968</u>
Total Tax Revenue	P17.0	P40.0	P52.7	P49.1 ^{a/}
Price Index (USAID)	100	216	305	407 ^{b/}
Real Tax Revenue	17.0	18.5	17.3	12.1

a/ Estimated.

b/ To December 2, 1968.

2. Second is the output of SVN-produced goods, including food. CY 67 was a year of great progress which was not continued in 1968 because of the problems created by the Tet offensive.

- a. Agriculture. The peasant perceives the GVN in large part in terms of security and prosperity. An important variable in this perception is the price of rice. Because of the Tet offensive, the rice subsidy, and rising costs, the price of rice and the profit is so low that large quantities of paddy from the past harvest season remain in delta stocks and are unsold. In an effort to improve this situation, the rice subsidy was effectively removed in November. As an added benefit, the rate of inflation should be reduced for two reasons: (1) the GVN will not spend piasters on the subsidy (the budget deficit will be reduced), and (2) the typical Vietnamese will now have to spend more money

CONFIDENTIAL

117

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for rice and less on other goods (the same amount of piasters now chases after higher priced goods and can make fewer purchases). Removal of the subsidy has a comparable impact to an increase in taxes.

Further steps to improve agriculture would be to promulgate the war risk insurance act and to improve the security of the transportation network. Both these steps should further increase the price to the farmer.

- b. Industry. The Tet offensive did some \$50 million damage to industry. Especially hard hit were several large textile plants. All industry suffered loss of production time during the attacks.

During the first eight months of 1968 output of most important industrial products declined sharply compared with the corresponding period of 1967. As shown in Table 7, only the output of cigarettes and electric power increased, while production of textiles and cement was down 40% to 50%. In July and August, however, monthly output of most items listed above began to approach the levels of 1967 indicating a resumption of near normal business activities.

TABLE 7

INDUSTRIAL OUTPUT

	<u>Unit of Measure</u>	<u>Jan-Aug 1967</u>	<u>Jan-Aug 1968</u>	<u>Percent Change</u>
Cotton Yarn	(000 m.t.)	4.6	2.5	-44%
Cotton Fabric	(mil mtrs)	28.9	13.7	-53
Beer	(mil ltrs)	87.8	76.1	-13
Soft Drinks	(mil ltrs)	61.5	58.3	-5
Refined Sugar	(000 m.t.)	59.4	56.6	-5
Cigarettes	(000 m.t.)	6.3	6.8	+8
Cement	(000 m.t.)	109.7	65.2	-41
Paper	(000 m.t.)	11.1	10.9	-2
Electric Power	(mil kwh)	445.9	450.0	

CONFIDENTIAL

118

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3. The issue of wages and the relative loss of purchasing power suffered by GVN employees including the military is still a substantial problem. While this problem results from inflation, wage increases have important consequences as a cause of inflation. The B and C projections in Table 3 for CY 69 contain a built-in wage increase and its impact on the "gap" can be observed. A wage increase might help solve much of the GVN's problem in the recruitment, retention, and motivation of employees as well as reduce the corrupt behavior of some of them.

The Foreign Exchange Market

The foreign exchange market can serve as a good indication of people's expectations about future price inflation or political and social instability. Gold and foreign currencies can serve as a good refuge for those who wish to hold their wealth in a form immune from inflation or less likely to be destroyed or expropriated in periods of social and political unrest.

During CY 67, the exchange markets for gold, dollars, and MPC were relatively stable with the piaster appreciating in value. 1968 has not been such a year. Since late November 1967, the piaster price of gold has risen continuously. This can be explained, at least in part, by conditions in the world gold markets which has seen gold prices in the free market at a substantial premium over the official price.

The piaster price of U. S. dollars was relatively stable throughout the first half of CY 68 but since mid-year the piaster has continued to depreciate. During August, the price of dollars reached its peak since the devaluation in June 1966, and has continued above the 200 piaster mark to the present time (see Chart 1).

The Outlook for 1969

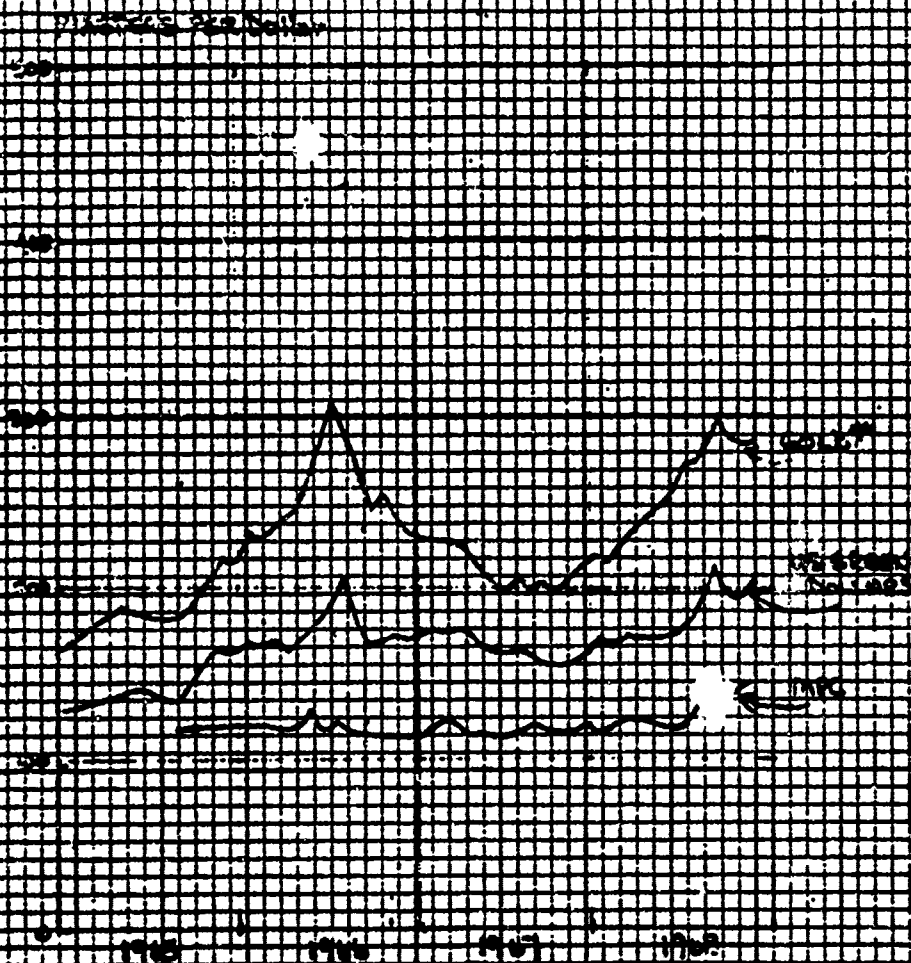
Continued progress in price stability can be made in 1969 barring a Tet type offensive or political and social instability. It should be possible to keep the rate of inflation from exceeding that of this year. The final picture will depend on many factors including the size of the GVN deficit, the size of the GVN armed forces, improvements in the revenue situation, revival and expansion of domestic production, and the level of imports.

CONFIDENTIAL

119

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SECRET
GOLD, US GREEN, AND DOLLARS



Source: 1968
REPORT OF US COMMISSION ON GOLD

CONFIDENTIAL

70

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VIETNAM'S NEED FOR EXTERNAL ASSISTANCE 1970-1974

Summary. Given US redeployment plans, no significant decrease in the level of conflict, no devaluation, and no change in the South Vietnamese tax structure, the inflationary pressures in the economy will become enormous as US forces withdraw from South Vietnam. To a significant extent the political stability of the Thieu regime depends on the support of fixed income individuals (Army and Civil Service) who would be most severely hurt by high rates of inflation, so a reasonable degree of economic stability seems to be clearly in our interest. Such stability, if achieved by additional American aid, would be expensive--requiring in some cases a three or four fold increase in the present levels of CIP (\$180 million in 1969) to bring inflation to reasonable levels.

Background

The primary objective of a recent A.I.D. study was to provide rough estimates of the amounts of external resources South Vietnam will require during the years 1970-1974, under varying assumptions as to the course of the war. The Terms of Reference which governed the Study Group prescribed limited rates of inflation (30% per year during wartime, 15% per year during peacetime), a ceiling on commodity imports (\$750 million per year) and the examination of other economic variables. The group was invited to make recommendations as to aid programs and projects and possibilities of institutional change, in addition to addressing itself to the principal objective.

United States resources enter Vietnam in a variety of forms, of which the following are the most important:

1. Military Assistance Service Funding (MASF). This includes military hardware and consumables, largely used in fighting the war; it also includes military support, construction and maintenance.
2. The Commercial Import Program (CIP). This is a form of economic aid used by A.I.D. to finance a selected list of commodities which are sold in Vietnam through commercial channels. The proceeds enable the GVN to support a higher level of public expenditure than would otherwise be possible.
3. PL480, Title I. This consists of U.S. agricultural commodities sold in Vietnam and having the same economic impact as CIP.
4. A.I.D. Project Assistance. This consists of goods and services provided directly to the Government of Vietnam to support the war effort or serve some other public purpose.
5. PL480, Title II. This consists of agricultural commodities distributed by voluntary agencies and having an economic impact similar to that of Project Assistance.

CONFIDENTIAL

121

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6. Dollars sold by the Department of Defense to obtain piasters needed to meet local expenses, and dollars exchanged as an accommodation to individual Americans. In both cases a subsidy is involved since the GVN pays fewer piasters per dollar than it receives from the resale of the dollars to importers and from the tax revenues which the imports so financed generate.

The table shows the primary sources of foreign assistance for Vietnam by type and amount for 1969.

SOURCES OF NON PROJECT FOREIGN ASSISTANCE FOR VIETNAM 1969

	Dollar Value (Millions \$)	Tariff Revenues (Billions Piasters)	Counterpart Generation (Billion Piasters)	Total Counterinfla- tionary Effect (Billions Piasters)
I. AID Sponsored				
A. CIP	\$ 180	7.1	20.6	27.7
B. PL480 Title I	90	1.5	10.6	12.1
TOTAL	\$ 270	8.6	31.2	39.8 a/
II. DOD Purchases				
A. Official	\$ 287	33.4	---	33.4
B. Personal	54	6.2	---	6.2
TOTAL	\$ 341	39.6		39.6

a/ 17.5 billion piasters of this is tied to US uses leaving only 22.3 billion piasters available for US piaster support of GVN budget.

CIP and DOD dollars were the resources most relevant to the study, because they provide local resources to the GVN national budget. Measured in other terms, they contract the money supply, and thus offset the GVN budget deficit, which expands it. One of the primary purposes of US aid to Vietnam is to provide a deflationary force to offset the inflationary effect of GVN spending for the war. Thus, it follows that with all other things being equal, one source of US resources must increase as another declines. DOD expenditures are expected to decline as US troops are withdrawn, and it is assumed that CIP must rise enough to replace them. It should be noted, however, that the tax revenues generated by GVN sale of DOD dollars to importers are markedly greater than those generated by the sale of CIP dollars because the DOD dollars are not subject to the restrictions put on use of the CIP dollars. Thus, it would require about \$1.50 worth of CIP to have the same anti-inflationary effect as \$1.00 of DOD dollars.

To measure the effect upon aid requirements of changes in the Vietnamese budget (for example, the planned increase in military forces) and changes in the availability of external resources (for example, the expected reduction in DOD dollar expenditures) the Study Group adopted a method developed by USAID/Vietnam

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known as Monetary Gap Analysis. The Group examined a wide variety of five-year projections grouped under three scenarios which incorporated three different sets of assumptions concerning the future of the war. Two of the scenarios assumed a high level of enemy activity and a maximum increase and improvement of Vietnamese military forces. Scenario A retained 250,000 US support and maintenance troops in Vietnam throughout the five-year period. Scenario B maintained a high level of Vietnamese forces but reduced US forces to a MAAG of 40,000 men by the end of 1973. Scenario C assumed a decline in the enemy threat, reduction of US forces to 10,000 men, and reduction of the Vietnamese forces by about one-half. This was the most optimistic scenario, yet even it requires substantial, external assistance throughout the five year period.

The Study Group could foresee no way in which the expense of the GVN force build-up could be met and the decline in DOD dollars offset, without actions which would, in one way or the other, violate the Terms of Reference for the study. Having at the outset taken US programs affecting the level of GVN expenditures for granted, the Study Group was led at the end to conclude that the expenditure side of the gap should be re-examined. The principal points of the study are outlined below.

Main Points

1. Both the redeployment of United States military forces and the build-up of Vietnamese armed forces planned for the next five years will add substantially to South Vietnam's need for external resources, the first by reducing the flow of United States dollars now spent by the United States military establishment and US troops and the second by increasing GVN budget expenditures. These pressures will produce an intolerable rate of inflation in the Vietnamese economy if additional external resources are not provided. The United States commitment to help South Vietnam take the steps necessary to compensate for the withdrawal of US combat forces implies a commitment also to provide these needed economic resources.
2. Throughout the war, GVN civilian as well as military expenditures have increased, largely because of the addition of war-related activities such as the care of refugees and pacification. There are no immediate plans to reduce these activities, and the Study Group concluded that when such a reduction does become possible equivalent civilian expenditures will be needed for development and reconstruction.
3. While there are trade-offs between project and non-project (material goods) aid, it is the non-project assistance, principally the Commercial Import Program, which is used to support civilian and military public expenditures. Therefore, if there is to be economic stability, we must assume that, as the GVN military budget increases and the supply of DOD dollars declines, the CIP will be increased accordingly.

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4. Such an assumption encounters serious difficulties arising from the fact that CIP is a relatively restricted and inflexible program. The eligible list of goods which CIP can provide is limited, excluding a wide range of merchandise now imported by the GVN with untied dollars supplied primarily by DOD purchases of piasters; such merchandise is in high demand and supports a much higher rate of taxation than is imposed upon CIP goods. As a general rule only goods of US origin are eligible for CIP financing. For those reasons, it may be impossible to substitute CIP completely for other sources of import financing.

5. There are inherent limitations in the use of imports as the sole or principal offset to inflation as they have been used in Vietnam. Heavy and increasing reliance upon such imports to compensate for the deficit in the public sector inevitably distorts patterns of production and consumption. Commercial imports in 1969 reached a level almost 27 times exports, and are approximately eight times the highest level Vietnamese exports have ever attained. They amount currently to \$40 per capita. This distortion already presents formidable obstacles to the eventual creation of an economically viable and self-sufficient Vietnam.

6. More reliance should be placed on other contractionary measures. Of these, the most obvious and important is an increase in domestic taxation. So far as the Study Group was able to determine, no such increase, in real terms, has taken place in Vietnam in the past nine years, and the group concluded that without some change in GVN and US policy it will not take place during the next five years. Nevertheless, the mobilization of more domestic resources in the interest of national objectives is desirable and should become a priority policy objective.

7. For the same reason it no longer seems appropriate to attempt to close the monetary gap, whatever it may be, solely by an increase in external resources. Smaller projected gaps are desirable. As a minimum, some limitation or control over the total GVN budget, such as is not now evident, should be imposed as a part of the joint GVN--US program to meet future resource requirements. The Study Group would not suggest a specific monetary ceiling but rather an understanding that with the support of a specific US aid commitment the GVN would undertake to maintain balance in the overall budget by reducing expenditures or increasing domestic revenues as required.

8. In any circumstances in which improvement in the security situation permits steps towards reconstruction and development, steps should also be taken to strengthen the private sector of the Vietnamese economy by the adoption of appropriate fiscal and monetary policies. The GVN should search for opportunities to transfer functions now performed by the government to private hands. This recommendation is made not as a matter of doctrine, but because the Study Group believes that with improvement in the security situation a shrinkage of the public sector will inevitably occur. That shrinkage can, under an appropriate set of policies, be safely offset by an increase of economic activity in the private sector.

Case 11

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ECONOMIC WARFARE AGAINST THE VIET CONG

Traditionally, the term economic warfare means to deny some or all imports to a country or group of countries. The aims may be several to force a change in policy, government, or military capability. But invariably the traditional battleground of economic warfare is the country's vital lines of supply. Economic warfare in Vietnam is difficult and different.

Quantification

First, we cannot blockade or economically isolate the VC. With roughly 300,000 hard core VC living among a population of some 16 million, only about one in 50 is a VC. To bring economic pressure on this enemy without doing the same to innocent citizens or even those friendly to your cause is no easy task.

Second, even where the VC can be isolated the GVN must maintain at least a facade of sovereignty over the entire country. The GVN, because it is trying to maintain its claim as the established government, attempts to provide schools, health clinics, transportation, etc., even in parts of the country considered VC areas. Representatives of the GVN are allowed to perform certain government services in VC areas during daylight hours while the VC concentrate their resources on more secret political and military goals. This situation accommodates the VC. But to stop these services also accommodates the VC.

Third, we do not know which items are critical to the VC. From caches and interrogation of VC defectors, it appears that generally the VC rely on getting regular supplies of arms, ammunition, explosives, food, clothing, and building materials. But no numbers are available by which to calculate the effect of denying the VC any of these items. The critical question, of course, is one of substituteability. There are wide degrees of substitution for many items.

Only two items might be called absolute necessities to the VC. One of these is salt; the other is anti-malaria medicine. Even salt has some substitutes in soy sauce and nuoc nam. Medical opinion, stressing human adaptability, says that in fact very little salt is a physiological necessity. But salt has a psychological importance. Men on a predominantly rice diet lose their appetite for it if eaten without salt.

Anti-malaria medicine is even more essential. The same medicine is used both in prevention of malaria and suppression after illness. In the highland of I and II Corps, where the malaria problem is most serious, the locals (the Montagnards especially) have acquired an immunity to it. The ones who suffer the most are "outsiders" - mainly the NVN troops who must pass through the area on their way South.

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But while both salt and anti-malaria medicine are "unsubstituteable", the requirements of the individual VC for these items appear modest. Too, these items can be packaged in small allotments which can be easily carried and easily hidden. So far then there are no candidates for a simple but effective denial program.

Fourth, present knowledge about VC supply system is vague. The VC get some of their supplies from the NVN (arms, ammunition) and some from within the country or from Cambodia (food, medicine). Some supplies are acquired in one part of the country (the Delta) to be transported to other areas or to be sold and the money used to buy necessities in other parts.

The VC may be spending P6 billion this year or P20,000 per man on supplies within SVN. The VC collect an estimated P3 to P4 billion in 1967. China and the USSR together are estimated to be buying another P2 billion per year on the black market for VC use. Where the goods are bought and how they get to where they are needed is often not known.

Circumstantial evidence suggests that the VC rely heavily on the sea and Cambodia as avenues of transportation. The main force units and the largest caches are near the sea and near the Cambodian border. Even supplies coming to the VC units from the Delta probably use either of these two routes. In-country transportation is difficult. The VC without access to road or rail must rely heavily on porters which takes a great deal of organization and manpower. (The local population might revolt if used as porters too frequently, for example).

Finally, we know little about how much the VC need. The requirements of a VC or NVA main force unit vary with the amount of military activity but they can be considerable. At a minimum, a VC soldier requires only 1.5 kgs of food per day and is issued a basic ammunition load of 7.7 kgs. At 1 engagement per month, a man needs about 1.8 kilograms per day, or 18 metric tons for a 10,000 man division. If the division consumes 5 ammunition loads per man per month, it would need 28 metric tons a month. Because of these potentially large requirements, the VC rely heavily on caches stocked in advance and the ability of their main force units to avoid military contact when necessary.

Present Situation

Presently, economic warfare in SVN concentrates on trying to deny goals to the VC. Road check points are manned by 6,500 National Police (there are plans to nearly double this force). For interdiction on the rivers there is the US Navy's Game Warden operation with 114 PBR's and 3 experimental Hovercraft. And on the sea, the US Navy and the US Coast Guard conduct Market Time patrol with 73 50-ft "Swifts" and 26 82-ft cutters.

These resources achieve very little. The check points on land are almost entirely stationary, placed on the main roads leading to and from major towns. They have little security, can easily be circumvented, and many close down at night.

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The VC can go around the checkpoints. They can also get their supplies through them. There is a long list of items which are contraband unless covered by a manifest. But there is no standard form for the manifest and manifests can easily be bought or forged. There is no incentive to the resources control police to give vehicles a thorough search - they receive the same pay no matter how many they examine and no matter what they find. Most vehicles get only a passing glance.

Resources control on the waterways has some of the same problems. A Vietnamese speaking interpreter is supposed to be on board each vessel but often there is none. With interdiction on the water, there is no room to unload and search a craft properly. And again there is the problem of the manifests.

Possibilities for Improvements

First, emphasis should be placed on getting more out of the present program. The scope of interdiction should be reduced from country-wide resources control to interdicting supplies on their way to the main force units. Check points should be mobile and should be along the main force units' possible lines of supply. Financial incentives should be provided for the resources control police. Rafts and piers are needed to unload and thoroughly search junks and sampans. The requirements of the manifest should be dropped and a small list of items (arms, ammunition, etc.) should be contraband in all cases.

Second, more effort should be concentrated on establishing, funding and publicizing a system of financial rewards. In counterinsurgency economic warfare, this is likely to have the greatest payoff.

Under counterinsurgency, when two governments are competing for the allegiance of the same population while at the same time trying to destroy the effectiveness of the opposition, tension and divided loyalties are inevitable. There is an opportunity to take advantage of this situation with a positive economic warfare program of financial rewards for such things as defection, information and turn-in of weapons.

The advantages of an effective rewards program are obvious - elimination of VC at a low cost (both in terms of money and lives), the opportunity for sowing seeds of distrust or divide the VC cadre from the people, and the possibility through informants of eliminating VC political cadre not often caught in military operations.

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Rewards alone are unlikely to produce many defectors or informants. People defect for various and complex reasons - some of them purely personal. Presently many are defecting because of hardships caused by military action. But an adequate system of rewards could be marginally quite effective. Even if only low level VC are thus induced to defect, many of them have quite valuable information and in large enough numbers, low level VC are important. No organization can be run with only chiefs and no indians.

Setting the appropriate level of rewards is both difficult and important. What is not known is the elasticity of supply for defectors, weapons or information. Cost-benefit calculations are not easy. For instance, the time and effort needed to process the additional flow of worthless information which will inevitably accompany higher rewards needs to be included as a cost.

The other major concern in any rewards system is the prevention of fraud, (e.g., people stealing weapons just to turn them in again). It is difficult to design a rewards system which cannot be corrupted even by officials on the GVN side.

Finally and most important, much more study and experimentation is needed on economic warfare in SVN. In order not to be counter-productive or to waste precious resources, economic warfare must proceed carefully with study and experimentation on a small scale before a plan is put into general policy. Experimentation to help determine, for example, the elasticity of supply in a financial rewards program or to determine the most effective placement of interdiction points would be most helpful. The logistics system and resource requirements of the VC are also examples of subjects which need a great deal of attention.

All of this is not very encouraging for those who look to economic warfare as providing a quick solution to the present conflict. But there are no quick solutions. All the programs with potentially quick results have been tried and most have failed. Anything that is worth doing in SVN, and economic warfare is worth doing, will take time to do properly. Economic warfare, like so many other things in a counterinsurgency situation must be learned.

Early 1967

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ECONOMIC WARFARE AGAINST THE VIET CONG - A REBUTTAL

AID has furnished comments in rebuttal to the June Southeast Asia Analysis Report article (pages 10-13) which challenged the effectiveness of road-blocks and water-craft control in interdicting the VC/NVA supply system. AID's comments follow:

"Last month's article indicates a less than complete understanding of the Resources Control Program, its organization and its impact on Viet Cong operations. For example, the statement is made that the Resources Control Program achieves very little, that the checkpoints on land are almost entirely stationary, that they can easily be circumvented, etc. As a matter of fact, the Vietnamese National Police operate 643 checkpoints; some fixed, some mobile, some land, some water and some combinations. 352 land, 103 water and 43 combination fixed checkpoints are in operation by the National Police along with 112 mobile land, 15 mobile water and 18 mobile combination checkpoints.

"While it is recognized that no system of controls or interdiction can be 100 percent foolproof, the solid results which have been achieved in the Resources Control Program can not be overlooked. For example, 292,000 individuals have been arrested in this program, including 15,780 Viet Cong and Viet Cong suspects; 9,930 ARVN deserters have been arrested along with 85,875 draft evaders; 9,570,000 kilos of foodstuffs have been confiscated, as have 327,000 units of medicines, drugs and antibiotics. Some dramatic seizures have occurred. For example, that of 15 tons of sheet steel, steel rods and steel pipes destined for a VC cottage industry gun factory and the seizure of a metal working lathe being delivered by a woman to the VC. There can be no question that seizures of such magnitude as these have had an important effect on the VC supply activity. For example, the checkpoint operation has forced the VC to disperse their supply carriers and has forced them to take special measures to evade confiscation. Obviously in the face of these statistics the statement that the Vietnamese National Police Resources Control Program achieves very little does not jibe with the facts.

"Resources Control as presently implemented deals with intermittent violators and at a low level. With few exceptions, RC checkpoints do not search military vehicles. There is room to believe that many military vehicles are used for illegal movement of goods. To eliminate such practices where they exist, RC checkpoints must be maintained on a 24-hour-a-day basis and provided with the unquestioned authority to halt any vehicle. This requires GVN action to permit the legal exercise of police authority at checkpoints and QC (Military Police), or other personnel, to backstop this exercise of authority. The lack of wholehearted GVN enthusiasm is often attributed to their concern for abusing the sensitivities of the population. It is extremely doubtful that this contention has much validity since the ARVN, Marines and other GVN military organizations have been grossly and knowingly abusing these sensitivities for years with little hinderance.

CONFIDENTIAL

130
129

"The analysis indicates that the VC will spend 6 billion piastres in CY 1967 for essential supplies in Vietnam. Obviously, the introduction of a new currency, with surprise, would deal them a shattering blow in any given year. Such a project could only be accomplished if closely held within the GVN structure. There is more than a little room for doubt that such a project could be kept under wraps in view of the VC connection and infiltration. However, this is the scope of thinking which is demanded.

"The heart of economic warfare, similar to the heart of anticorruption measures, rests with the GVN. If the desire to properly address the problem does not sincerely exist within the government structure, suitable results are unlikely to obtain."

The AID comments are a useful addition to our information. Unfortunately, the AID numbers do not help too much in assessing the efficiency of the operation. Are the figures a large percentage of the total, or only a small percentage? To illustrate, since the National Police Force began the Resources Control Program in 1964, 158,800 ARVN troops have deserted. Resources Control checkpoints have apparently arrested only 9,930 or 6% of these deserters. Similarly, the figures show how many supplies Resources Control has confiscated, but we do not know how much has been missed.

A number of changes in the Resources Control Program might improve it without needing significant additional resources. The scope of interdiction could be reduced from country-wide resources control to interdicting supplies on their way to main force units. All checkpoints should be mobile, not just the 23% mentioned in the previous article. Financial incentives (more confiscations, more pay) should be supplied for Resources Control Police. The requirements of the manifest should be dropped (manifests are easily bought or forged) and a small list of critical items (arms, ammunition, etc.) should be declared contraband.

We would welcome readers' comments.

CONFIDENTIAL

SOCIAL AND ECONOMIC DEVELOPMENT IN THE SVN HIGHLANDS

A recent RAND study* states the need for GVN to win the Highlanders' (Montagnard) support in order to gain control of the strategic mountain areas of SVN. GVN must move quickly to grant some local autonomy, raise agricultural production, improve schools, expand Highlander courts, grant clear land titles, and increase Highlander participation in the central government.

The French let the Highlanders cultivate their own language, customs and courts of justice, thus leaving their connection with national institutions quite loose. In contrast, the Diem government tried to assimilate the Highlanders into Vietnamese society in ways that aroused discontent, active protest movements (such as FULRO) and even armed rebellion. Despite past setbacks in the Highlanders-GVN relationship, the climate for resolving major difficulties is now favorable; GVN must exploit it promptly to gain highlander support and avoid future conflict which would hurt the war effort.

The GVN would reap many benefits from active Highlander support. It would acquire 3000-5000 armed FULRO troops skilled in jungle warfare and very familiar with the mountain terrain near Cambodia. Moreover, GVN could greatly improve its intelligence network at the village level in areas where FULRO has a strong popular following. Ultimately, a mutual accommodation would serve the important objective of weaving the various ethnic groups into the fabric of Vietnamese society.

In return for their support, the Highlanders seek GVN guarantees that will leave their people free to preserve their languages and customs while granting them opportunities for greater participation in Vietnamese political life and for more direct control over the administration of the Highlands. Despite much vacillation, the GVN has made some progress towards convincing the Highlanders of its good faith. GVN must learn more about Highlanders needs and become more responsive to them. It must act promptly to raise Highlander agriculture from subsistence to cash crop level, provide more schools, give Highlanders clear title to the land they now farm, slowly expand and increase the competence of the Highland law courts, and give Highlanders greater representation in the central government.

*RM-5281-ARPA, May 1967: "The Highland People of Vietnam: Social and Economic Development (U)." Gerald C. Hickey.

CONFIDENTIAL

C. Smith 1069

CONFIDENTIAL

Rice Production and Consumption

In 1963, SVN exported 322.6 thousand tons of rice. In 1966, 434.0 thousand tons of rice were imported (see Table 1). This is a net change of 756.6 thousand tons. (An even higher level of imports, 760.0 thousand tons, is predicted for CY 1967.)

The reasons for this dramatic shift are basically two: decreased production and increased consumption. Decreased production is the most important reason. Between 1963 and 1966, war disruptions, the popularity of other crops (e.g., vegetables) and the movement of labor into other employment resulted in an estimated drop in rice production of 434.0 thousand tons. (See Column 1 of Table 1). Deliveries to Saigon have also dropped (Column 2) and are now a lower percentage of estimated production than prior to 1963 (See Column 3).

Decreased production than is estimated to account for 480.0 thousand tons (or 63 percent) of the net change (756.6 thousand tons) in SVN's rice trade since 1963. The remainder (276.6 thousand tons) is attributed to increased consumption.

Consumption (production less exports plus imports) is estimated to have increased from 2,717.4 thousand tons in 1963 to 2,984.0 thousand tons in 1966. This is primarily due to population increases (estimated to be growing at 2.8 percent per year). Table 2 indicates that rice consumption per person has not increased significantly. These estimates are very rough. Both the production estimates and the population estimates are not very reliable and this calculation allows for no rice losses (war destruction, illegal exports, animal feed, etc.).

SVN will not be able to export rice in the future unless production can be increased above previous peaks. In 1966, consumption was 2,984.0 thousand tons - slightly lower than recent peak production years of 1960 and 1963.

We do not know how much rice, if any, has been shipped to Cambodia. Those who claim that such shipments are large estimate much higher production than those figures given in Table 1. Shipments to Cambodia were thought to take place because of the higher price for rice in Cambodia. Since the recent price increase in Saigon, the reverse is true and there is some evidence that rice is now coming into Vietnam from Cambodia.

CONFIDENTIAL

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TABLE 1

SOUTH VIETNAM RICE
(Production, Saigon Deliveries, Exports, Imports)
(Thousand Metric Tons)

<u>Year</u>	<u>Estimated Production Milled Rice</u> ^{a/}	<u>Deliveries to Saigon</u>	<u>Deliveries as a percent of Production</u>	<u>Exports</u>	<u>Imports</u>
1957	-	434.1	-	183.9	0
1958	1,915.2	426.5	22.3	112.7	0
1959	2,614.8	575.6	22.0	245.7	0
1960	3,055.2	562.3	18.4	340.0	0
1961	2,973.0	553.8	18.6	154.4	0
1962	2,764.2	580.3	21.0	83.9	25.0
1963	3,030.0	727.3	24.0	322.6	0
1964	2,790.0	505.3	18.0	48.6	0
1965	2,700.0	420.6	15.6	0	123.0
1966	2,550.0	308.0	12.1	0	434.0
1967	-	230.0 (est)	0	0	760.0 (est)

^{a/} Estimates from Joint Embassy/AID Economics Division.

CONFIDENTIAL

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TABLE 2
SVN RICE CONSUMPTION

<u>Year</u>	<u>Population</u>	<u>Rice Consumed (metric tons)</u>	<u>Consumption (per head)</u>
1959	13,789,000	2,369,100	172 kg
1960	14,100,000	2,751,200	193
1961	14,494,000	2,818,600	194
1962	14,929,000	2,680,300	180
1963	15,317,000	2,707,400	177
1964	15,715,000	2,741,400	174
1965	16,124,000	2,823,000	175
1966	16,543,000	2,984,000	180

CONFIDENTIAL

Revised 1967

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Rice Problems in SVN

In five years Vietnam has shifted from exporting 300,000 tons of rice to importing 900,000 tons. This has created a major problem of inter-region and inter-province distribution. While ports are adequate, warehouse facilities are not, placing a heavy burden on the commercial trucking industry outside of Saigon. This industry, in turn, cannot move rice in the quantities required, along with other cargoes. We must quickly insure prompt distribution of rice to local markets to avoid widespread popular discontent in secure and contested areas, rapid rises in rice prices, and inadequate assistance to the expanding refugee population. The answer appears to be the use of military assets to augment commercial trucks in the distribution of rice. But we have no current plans to do so nor have we examined the effects such a diversion of military assets would have on the capacity of RVNAF and FVMAF to carry out combat and pacification operations.

Production, Consumption and Imports

Rice production in Vietnam has shown a steady marked decline for the past five years (see Table 1). This decline is paralleled, with the exception of the 1964/65 period, by a reduction in the number of hectares under rice cultivation. Yield (metric tons/hectare) has remained relatively constant throughout the same period.

TABLE 1

SOUTH VIETNAM RICE
(Production, Area Cultivated, Yield)

<u>Year</u> <u>a/</u>	<u>Estimated Production</u> <u>Milled Rice</u> <u>b/</u>	<u>Number of Hectares</u> <u>Rice Cultivated</u> <u>b/</u>	<u>Yield</u> <u>(M Tons/Hectare)</u>
1962/63	3123.0	2479	2.1
1963/64	3142.0	2538	2.1
1964/65	3110.0	2562	2.0
1965/66	2893.2	2429	2.0
1966/67	2601.6	2295	1.9

a/ Rice year begins June 1 and ends May 30 of the next year.

b/ Data through 1966 from USAID Annual Statistical Bulletin, Vietnam #10.
1967 data estimated from USDA, Econ Research Service Rice Situation (RS-11) January 1967.

CONFIDENTIAL

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Through the same period South Vietnam's rice export trade disappeared and produced the requirement for substantial imports of rice from the US, Taiwan, and Thailand. This situation presumably is due to increased VC activity and the reduction in hectares producing rice. Pertinent statistics appear in Table 2.

TABLE 2

SOUTH VIETNAM RICE: EXPORTS/IMPORTS (Metric Tons)

<u>Year</u>	<u>Exports</u>	<u>Imports</u>
1963	322.6	0
1964	48.6	0
1965	0	123.0
1966	0	434.0
1967	0	900.0 (Est) a/

a/ American Embassy, Saigon.

The 900,000 tons of imports in 1967 is too precise. It includes 100,000 tons from Thailand and 20,000 tons from Taiwan with the residual of 780,000 tons to be furnished by the US under Title 1, PL 480. At the present time, the GVN has completed purchase of only 30,000 tons of Thai rice, making a firm order of only 810,000 tons. However, if the US ships the other 90,000 tons and the GVN then buys the 70,000 ton balance from Thailand, imports could go to 970,000 tons.

The GVN estimates the consumption deficit (the difference between estimated production and consumption computed by multiplying average per capita consumption times population either in secure or contested areas) is approximately 1.1 million tons. A possible explanation of the variance between projected imports and the consumption deficit is that rice production is decreasing faster than the statistics indicate; for example, war damage is commonly mentioned by refugees, POW's and ralliers as a cause of decreased production. Also the flow of refugees into urban areas would lead us to expect both decreased rice surplus in previous export areas. A deficit of 1.1 million tons and imports of 900,000 tons would mean a serious food shortage and popular unrest.

Distribution

The magnitude of rice production/deficit problem is further compounded by distribution inadequacies. Historically Vietnam's prolific rice harvest in the Mekong Delta region and its waterway system were a happy combination. Barge transportation was an inexpensive and convenient means of getting a large volume of paddy rice from the producing area to Saigon's milling, marketing, and export-

CONFIDENTIAL

136

CONFIDENTIAL

ing facilities. However, increased Viet Cong activities and the controlled low price in Saigon have lessened both the level of production and the use of the waterways to transport rice to Saigon. Furthermore, the rest of SVN historically has produced enough rice to meet its consumption needs. However, the war (security conditions, combat operations, refugees, etc.) has made this into a rice deficit area.

Rice is imported and distributed through the four port areas of Saigon, Quinhon, Nha Trang and Danang. Each of the port areas have the capacity to handle rice in the amounts required; however, in spite of an expanded warehouse construction effort, there is a storage deficiency in each area. This deficiency can be offset by more rapid distribution of rice within the region or province utilizing trucks. The trucking industry of Vietnam, however, by all indications, is not capable of handling a problem of this magnitude. For example, trucking firms own limited rolling stock and restrict their rice operations due to security conditions, profitability of alternative cargoes such as human passengers and the high rice "squeeze" at GVN check points. The latter derives from the portability and immediate resale value of rice as opposed to such items as a piece of machinery with a stamped serial number.

I CTZ, A Case Study

I CTZ illustrates the distribution problem most clearly. Table 3 indicates the 1967 production estimate of rice based on the civilian population living in secure and contested areas.

TABLE 3

I CTZ REQUIREMENTS FOR MILLED RICE

Population in Secure and Contested Areas ^{a/}	1,731,000
X Annual Per Capita Consumption (MT)	X .144
= Total Requirement (MT)	<u>249,000</u>
Total Requirement (MT)	249,000
Less Estimated Production (MT)	<u>-99,000</u>
Import Requirement (MT)	150,000

a/ Total I CTZ Population = 2,375,000

The extent of the decline of rice production in I CTZ is shown below in Table 4. The decline in production between 1963-1967 is 49% or approximately three times the national average, and has occurred most markedly in the past year and a half. It is probably due to the intensity of the combat and pacification efforts.

CONFIDENTIAL

137

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TABLE 4
I CTZ RICE PRODUCTION (1963, 65 & 67)

	<u>MILLED RICE (UNIT IN M/T)</u>		
	<u>1963</u>	<u>1965</u>	<u>1967</u> ^{a/}
Quang Tri	17,600	13,750	14,700
Thua Thien	31,900	34,650	30,300
Quang Nam	39,000	38,225	13,500
Quang Tin	38,300	46,200	22,300
Quang Ngai	66,000	22,000	18,000
Total	192,800	154,825	98,800

^{a/} Source: US AID Agriculture Division, I CTZ, Sep 67.

During 1967 the civilian truck transport available in I CTZ has been inadequate to move 150,000 tons of imported rice and other cargoes, such as fertilizer, human passengers, livestock, relief supplies, and manufactured goods. However, AID/Vietnam estimates that only 4,000 - 6,000 (of the total SVN 40,000 commercial trucks) are available outside of the Saigon area for rice hauling. About 400 trucks would be needed just to move the I CTZ rice requirement. Considering the large volume of other demands in I CTZ on the small number of available trucks, the commercial truck system is clearly inadequate. The deficiency in truck transportation was made up by ARVN and FVMAF on an "as needed" basis. The long-term effects remain to be analyzed on the use of military trucks, and particularly the effect on the ability of the South Vietnamese to maintain a sound economy after the war.

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